

Georgia State University

a unit of the university system of georgia

university plaza
atlanta, georgia 30303

college of business administration
economic forecasting project
404/658-3282

MONTHLY PROJECTIONS OCTOBER 1985

Dr. Donald Ratajczak, Director
For Release: October 28, 1985

LEAN INVENTORIES TO STIMULATE PRODUCTION IN NEXT TWO QUARTERS

In the past year, sales of manufacturing and trade have increased 3.6% while inventories have expanded 2.9%. This does not appear to be a large discrepancy, but declining prices for many of the goods held in inventory have biased estimates of inventories upward relative to sales. In the preliminary GNP release for the third quarter, the book value of inventories overstated the replacement cost of those inventories by \$6.1 billion. Moreover, sales have spurred in August and September while inventories have declined. For example, our projections suggest that sales have grown 5.2% in the past twelve months through September while inventory expansion will be a meager 1.7% increase. Vendor performance suggests that inventories on the shelves are becoming lean, as delivery delays nearly doubled in the September report. Also, inventories of fuel oil are almost dangerously low, falling 25 million barrels below levels normally assumed to be acceptable for this time of year. Indeed, the shortage of fuel oil has begun to spark a price rally for both petroleum product and crude petroleum in recent weeks.

While some temporary spurts in prices can be anticipated from the unusually lean position of inventories relative to sales, substantial excess production capability can be brought to bear to remove any temporary shortcomings. Thus, price spurts, even for the petroleum-based products, are expected to be temporary. However, production spurts certainly should be expected.

In September, production did not respond to increased sales, as those sales gains were assumed to be the result of temporary incentives. However, sales have now substantially reduced available inventories all the way from finished parts to crude materials. These inventories may not prove to be adequate even at reduced sales levels during the fourth quarter. Therefore, a spurt in production and in GNP is anticipated in the months ahead. As production remained subdued in September, it is unlikely that real economic activity during the fourth quarter can expand in excess of 4%, as previously projected. However, production in excess of 3% for the next two quarters appears to be likely even as consumer spending slows sharply from earlier in the year.

Of course, consumer spending should slow sharply. The savings rate in September fell below 2%, although a \$6 billion write-off of property values at annual rates for the effects of Hurricane Elena partially contributed to such a low savings rate. Hurricane Gloria will have a similar, slightly smaller impact upon rental incomes in October. However, income should gradually accelerate, especially as interest incomes begin to contribute favorably to household income in the fourth quarter and early in 1986. Nevertheless, consumer spending should show no growth in the fourth quarter as savings rates are gradually rebuilt, especially by consumers who shifted automobile purchases into the third quarter to take advantage of especially favorable automobile financing. Even with this projected sluggish consumer spending, the savings rate remains remarkably low well into 1986. A favorable ratio between wealth and consumption provides justification for such low rates of saving, but any substantial retrenchment in equity values almost certainly would generate more sluggish consumer spending than currently anticipated. Under such circumstances, no inventory buildup will be needed and a recession in the latter half of 1986 would become very likely.

Construction orders remain surprisingly robust, with private nonresidential orders rising 12% from previous year levels in the latest month. Early projections for 1986 suggest further increases into the year before declines begin materializing by mid-year. However, the lagged response between expenditures and orders suggests that nonresidential spending will continue to grow until the last quarter of next year.

The current economic condition, where inventories are lean but consumers are exhausted, poses a difficult dilemma for the Federal Reserve. Inflationary pressures probably will momentarily surface because some inventories, especially petroleum products, are unusually tight. In addition, the buildup of inventories will tend to increase interest rate pressures. Money growth as measured by currency and checkable deposits already has been excessive. If the Federal Reserve accommodates the inventory buildup, money growth will intensify. On the other hand, if the Federal Reserve reacts against temporary expansion of activity and momentary increases of inflation, then rising interest rates could weaken equity values. Also, strengthening interest rates while economic activity is rebounding almost certainly would strengthen the dollar against foreign currency. This would expose the manufacturing sector to renewed weakness and also create downward pressures upon consumer spending. Fortunately, the currency interventions initiated last month by the Group of Five have permitted enough dollar liquidity to migrate home to moderate money growth without seriously increasing interest rates. This might provide the Federal Reserve with a few more months of watchful waiting before renewed rapid money growth requires a choice between increasing inflation or rising interest rates.

Equity markets should be slow to react to rising rates of interest until early 1986. The preliminary GNP estimates for the third quarter suggests that corporate profits after taxes were up 4.8%. Operating profits less tax liabilities were up more than 6%. Although interest rates have increased since June, increases have been much smaller than gains in profitability. As a result, equity values should have risen more substantially than they have. With further significant gains in corporate profitability anticipated for the fourth quarter, new highs should be recorded on all major stock indices before the quarter is through.

Quarterly Profile of GNP

	<u>1985-2</u>	<u>1985-3</u>	<u>1985-4</u>	<u>1986-1</u>	<u>1986-2</u>	<u>1986-3</u>
Real:	1.9	3.3	3.3	3.0	2.0	0.8
Price:	2.6	3.3	4.5	3.3	3.8	4.7
Nominal:	4.5	6.7	7.9	6.4	5.9	5.5

Monthly Statistical Highlights for October 1985

Payroll employment +189,000; index of hours worked +0.2%; household employment +239,000; civilian unemployment rate 7.1%; personal income +0.4%; savings rate 3.1%; personal consumption -0.9%; retail sales -3.8%; auto sales 9.6 million; housing starts +4.2%; housing permits -3.0%; construction expenditures -0.3%; business inventories +0.4%; orders for durable goods +0.4%; orders for nondefense capital goods -1.5%; industrial production +0.4%; CPI +0.3%; PPI +0.6%; consumption deflator +0.9%; leading indicators +0.1%; real GNP +2.9%; M1 -2.1%; M2 +6.1%.

Monthly Statistical Highlights for November 1985

Payroll employment +314,000; index of hours worked +0.3%; household employment +368,000; civilian unemployment rate 7.0%; personal income +0.5%; savings rate 2.9%; personal consumption +0.9%; retail sales +1.4%; auto sales 10.2 million; housing starts +5.9%; housing permits -2.1%; construction expenditures +0.4%; business inventories +0.7%; orders for durable goods -0.6%; orders for nondefense capital goods -1.3%; industrial production +0.4%; CPI +0.4%; PPI +0.2%; consumption deflator +0.4%; leading indicators +0.1%; real GNP 2.1%; M1 +3.8%; M2 +7.4%.

COMMENTARY

Employment Situation - Weakness in manufacturing payrolls was especially disconcerting, as payrolls in the machinery sectors again slipped sharply. Virtually all the weakness was in durable goods, and this was confirmed by the industrial production report and the shipments in durable goods industries. However, increasing orders for durable goods other than defense suggests that payrolls in the machinery sector will not be as weak in the months ahead. The Chrysler strike will have a modest impact upon employment of transportation equipment personnel in October. The insured unemployment rate is consistent with a slightly higher level of unemployment than the 7.1% recorded in September. However, initial unemployment claims are slightly below previous month levels. Therefore, no change in unemployment is anticipated in the next report.

Of more favorable consequence is the largely unchanged hourly earnings index in the past three months. Over the past year this index has increased only 2.4%, the lowest year-over-year comparisons in this expansion. Obviously, the unemployment rate remains above levels that would create increasing wage inflation. Wages are expected to increase more sharply as the CPI begins to accelerate. Nevertheless, the hourly earnings index has been revised to show much smaller increases in the next year than originally anticipated.

Personal Income & Outlays - The moderation in wage gains is largely responsible for slower growth in wages and salaries than contained in our previous forecast. However, wages and salaries expanded 0.8% in September as industries paying high wages added to their hours worked. Such a rapid increase is not anticipated during the next few months. On the other hand, hurricane damage sharply reduced rental incomes after the property losses were annualized. This factor reduced September personal income by \$6 billion and will also hold October incomes \$6 billion below what would occur in the absence of hurricane damage. The weakness in interest income is surprising, as interest rates reached their low points in June. Perhaps, certificate roll-overs and reduced holdings of interesting bearing instruments may be responsible for this continued decline in interest income. Gains are anticipated in this area of property income during the next few months.

Farm income also is expected to show a modest spurt in the fall as a result of improving meat prices. Our PPI survey shows that agricultural prices rose 3.0% in October. In addition, non-farm proprietor's income should continue to expand by more than \$2 billion per month.

After surging well above trend in August and September, automobile sales should fall below trend in October before regaining a reduced trend-like growth rate in subsequent months. Our projections suggest that some of the automobile sales surge was at the expense of future sales. With increasing prices for non-durable goods, some acceleration is anticipated in spending for those commodities in the next few months. This will be moderated to some extent by slower gains in service expenditures, especially housing and transportation services, than originally projected.

Construction - Weakness in housing starts during September cannot be readily explained. Permits remain unusually robust while construction activity has sagged. In the rental property area, builders may be delaying initial work on permitted units because rental markets currently are overbuilt. Yet, builders would want to accelerate construction once again if prospects for tax reform re-emerge in 1986. Some of the weakness in single-family starts may be the result of weakening sales in parts of the south and west. Sales of previously owned homes declined 2% in September even though mortgage financing remained favorable. Apparently, all the pent-up demand for housing has been met at current affordability rates. Unless affordability sharply increases, a prospect that appears dim, little further acceleration in housing activity should be anticipated. If interest rates rise, as we anticipate early in 1986, some weakness in housing activity should re-emerge. At the present time, the weakness in housing starts during September is being treated largely as an aberration. Nevertheless, that aberration will restrain expenditures for residential construction through the fourth quarter.

Other construction is gradually rebounding. Public construction remains on a relatively high plateau following a burst of activity earlier in the year. Private nonresidential activity is rebounding following a mid-year slump. Some of that slump may also have been the result of tax reform fears.

Business Activity - The most substantial shift in business activity is in inventory accumulation, where increasing production and reduced sales should add to business inventories in October and November. In September, shipments of durable goods fell 2.4% while orders other than for defense increased 0.7%. Although defense orders were down 19.3%, this was the result of no unusual B-1

bomber orders in September following two months when those orders were substantial. Defense orders still exceed shipments by more than \$1 billion. More significantly, orders for nondefense capital goods now exceed shipments by \$2 billion. This almost certainly indicates that shipments will be rising during the fourth quarter.

Industrial production was revised to show greater weakness in July than originally reported. The surge in August was larger than originally stated, probably reflecting the faulty seasonals that appeared in the employment statistics but were absent from the initial industrial production report. If so, much of the weakness in industrial production during September is merely unwinding those seasonal patterns. This should set the stage for significant expansion during the fourth quarter.

Prices - Two offsetting composition shifts impacted the GNP deflator during the third quarter. The sharp plunge in inventories caused an increase in inflationary pressures. At the same time, shifts in consumer spending toward automobiles lowered the consumption deflator. These composition shifts will largely reverse themselves during the fourth quarter, although the slowing in automobile sales and its impact upon the consumption deflator may be slightly more dramatic than the rebound in inventories.

Of greater consequence than the composition shifts is the increasing inflationary pressures caused by temporary shortages of petroleum products. In addition, meat prices momentarily have firmed. Indeed, the 0.2% increase in the CPI during September was disappointing as financing incentives and less than seasonally anticipated tuition increases tended to hold down the index. In addition, the sawtoothed pricing pattern for rentals and homeowners' costs had reached a low point in September. While our projections show CPI rising 0.3% in October and 0.4% in November, more rapid gains than that are possible. Of course, the surge in energy prices is temporary and should reverse sometime in the latter part of the winter months. These pricing patterns are incorporated in our inflationary projections.

Miscellaneous - Gradually accelerating inflation and slowing money growth should lead to reduced contributions from the money stock in the leading indicators. In addition, housing permits cannot continue to rise when they already are more than 150,000 above starts. The dollar devaluation has led to some firming of sensitive prices. In addition, the workweek already is unusually long for this stage of the business cycle. Thus, many of the leading indicators that have been moving upward are not expected to contribute significantly to advances in the months ahead. This explains the relatively flat pattern anticipated for the leading indicators over the next 12 months.

A large portion of the inventory valuation adjustment that must be added to inventory values is the result of energy materials. The current rebound in energy prices should cause that positive IVA to dissipate.

FINANCIAL MARKETS

During the period of inventory liquidations in the third quarter, corporate uses of funds were falling even more sharply than household savings rates. Government deficits continued to hover in the \$150 billion consolidated range that had been established several quarters ago. As a result, downward pressures

would have been exerted upon interest rates except for the rising interest rate premiums required by foreign investors to offset modest concern that the dollar might be falling in value.

During the fourth quarter, foreign investors are not expected to be more concerned about future weakness in the dollar's value, as the currency market intervention has brought the dollar down to a point where foreigners can contemplate a rally. Indeed, substantial foreign investor support for government borrowings is anticipated once the debt limitation restraints are lifted and government bonds again are aggressively issued during November and early December. However, the inventory buildup should cause greater corporate use of borrowings. Some of this already is being reflected in rising commercial paper rates and increases in the quantity of commercial paper outstanding. Although households should increase their savings during the fourth quarter, this is not expected to be sufficient to offset the swing in corporate borrowing needs. As a result, interest rates should begin trending upward before the end of the quarter. Further upward pressures upon interest rates are expected early in 1986 as inventory borrowings intensify even as corporate profitability begins to be squeezed by rising interest costs. Toward the end of the year, however, weakness in construction should begin to generate renewed interest rate relief.

Equity Markets - Because of the sluggish rebound in interest costs, returns to equity owners have been larger than expected in the third quarter and also should rise sharply during the fall. Such earnings should not rise significantly in 1986, however. With equity gains rising more rapidly than interest rates until 1986, the stock market should be able to generate highs on most of its leading indicators. In 1986, pressures upon corporate profitability and modestly rising interest rates until the latter part of that year should cause equity values to drift downward. Thus, equity owners should maintain their positions through 1985 but begin diminishing their equity portfolios early in 1986 in contemplation of a modest decline in equity values.

EMPLOYMENT

	Payroll Employment		Index of Hours Worked		Household Civilian Employment		Civilian Unemployment Rate		Hourly Earnings Index	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1985	97120	97120	115.6	115.6	106945	106945	7.3	7.3	164.8	164.8
May	97386	97421	116.2	116.2	106960	106960	7.3	7.3	165.0	164.9
June	97466	97473	116.5	116.3	106370	106370	7.3	7.3	165.4	165.7
July	97639	97707	116.8	116.0	106865	106862	7.3	7.3	165.9	165.4
August	97952	97987	117.0	116.7	107180	107172	7.3	7.0	166.4	165.6
September	98265	98115	117.3	117.2	107494	107544	7.3	7.1	166.8	165.6
October	98429	98304*	117.6	117.4*	107765	107783*	7.2	7.1*	167.4	165.9*
November	98652	98618	117.9	117.7	108079	108151	7.2	7.0	168.0	166.3
December	98869	98785	118.1	117.9	108246	108357	7.2	7.0	168.7	166.7
January 1986	99027	98978	118.3	118.1	108453	108580	7.2	6.9	169.3	167.2
February	99196	99162	118.5	118.3	108689	108805	7.1	6.9	170.0	167.7
March	99311	99346	118.7	118.5	109237	109051	7.1	6.8	170.6	168.1
April	99507	99723	118.8	118.7	109534	109253	7.0	6.8	171.1	168.6
May	99648	99723	119.0	118.9	109475	109471	7.0	6.8	171.6	169.2
June	99798	99832	119.2	119.0	109107	109505	7.0	6.8	172.2	169.8
July	99943	100000	119.3	119.2	109771	109808	7.0	6.7	172.8	170.3
August	100126	100101	119.5	119.3	109969	109903	7.0	6.7	173.4	170.8
September	100336	100226	119.6	119.3	110062	110019	7.0	6.8	174.0	171.4

PERSONAL INCOME

	Personal Income		Wage & Salary		Personal Savings		Disposable Income		Personal Outlays	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1985	3.186	3.185	1.903	1.903	145.7	143.4	2.721	2.719	2.575	2.576
May	3.164	3.164	1.908	1.908	171.8	174.3	2.765	2.764	2.594	2.590
June	3.176	3.176	1.917	1.921	90.8	100.4	2.696	2.696	2.606	2.596
July	3.198	3.189	1.930	1.923	98.8	104.0	2.722	2.707	2.623	2.603
August	3.220	3.199	1.942	1.934	109.6	79.2	2.744	2.713	2.634	2.634
September	3.243	3.209	1.953	1.949	118.9	51.9	2.765	2.717	2.646	2.665
October	3.261	3.223*	1.964	1.957*	115.4	85.8*	2.778	2.729*	2.663	2.643*
November	3.280	3.245	1.975	1.967	115.5	80.6	2.792	2.748	2.677	2.667
December	3.300	3.260	1.986	1.975	107.3	78.2	2.803	2.760	2.696	2.681
January 1986	3.311	3.275	1.996	1.985	111.1	84.6	2.820	2.773	2.709	2.688
February	3.335	3.292	2.006	1.994	120.1	87.6	2.842	2.787	2.722	2.699
March	3.363	3.310	2.015	2.003	130.0	90.2	2.864	2.802	2.734	2.712
April	3.375	3.327	2.025	2.012	123.3	88.5	2.874	2.816	2.751	2.728
May	3.385	3.349	2.034	2.024	115.3	91.1	2.883	2.835	2.768	2.744
June	3.396	3.366	2.043	2.033	107.6	91.6	2.892	2.849	2.784	2.757
July	3.413	3.385	2.054	2.043	106.3	94.9	2.908	2.865	2.802	2.770
August	3.426	3.401	2.065	2.051	100.7	93.1	2.921	2.878	2.820	2.785
September	3.440	3.417	2.076	2.059	98.8	91.2	2.934	2.890	2.835	2.799

Fore. = August Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

CONSUMPTION

	Personal Consumption		Durables		Nondurables		Services		Consumption Real	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1985	2482.7	2483.0	341.0	341.0	894.1	894.1	1247.6	1247.9	1100.3	1100.7
May	2499.7	2495.6	342.7	342.7	891.2	891.2	1265.8	1261.8	1104.6	1103.9
June	2510.1	2500.4	336.2	333.9	892.1	890.4	1281.8	1276.1	1105.1	1101.6
July	2526.4	2506.9	339.6	336.9	898.4	892.1	1288.4	1277.9	1109.0	1103.1
August	2536.2	2536.1	340.9	357.4	903.8	893.6	1291.5	1285.1	1110.9	1114.8
September	2546.6	2566.6	343.7	372.5	908.3	901.1	1294.6	1292.9	1113.5	1127.9*
October	2561.5	2542.9	344.1	336.0*	910.8	906.3*	1306.6	1300.6*	1116.1	1107.5
November	2573.6	2565.6	342.7	345.6	911.6	911.7	1319.3	1308.3	1117.5	1113.2
December	2591.1	2578.8	344.6	346.5	914.5	914.5	1332.0	1317.8	1121.2	1115.9
January 1986	2603.1	2584.2	345.5	341.4	916.9	916.4	1340.7	1326.4	1122.0	1114.4
February	2615.0	2594.5	346.3	341.2	919.7	918.2	1349.0	1335.1	1122.8	1116.2
March	2626.0	2605.7	346.2	343.5	922.5	918.0	1357.3	1344.2	1123.2	1118.8
April	2641.2	2620.2	345.5	345.9	927.6	921.5	1368.1	1352.8	1125.8	1122.6
May	2656.7	2635.3	345.6	347.5	932.5	926.2	1378.6	1361.6	1128.1	1125.7
June	2671.9	2647.6	346.0	348.3	937.4	928.4	1388.5	1370.9	1130.2	1127.1
July	2687.9	2659.1	346.8	347.6	943.7	932.0	1397.4	1379.5	1132.7	1127.9
August	2705.3	2672.8	348.1	347.5	949.0	936.7	1408.2	1388.6	1135.7	1130.0
September	2719.0	2685.5	348.5	347.9	951.6	939.3	1418.9	1398.3	1137.2	1131.3

RETAIL SALES

	Retail Sales		Non-Auto Durables		Auto (Million Units)		Nondurable Sales		Auto Sales	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1985	115.35	115.35	16.71	16.71	11.1	11.1	72.42	72.42	26.23	26.23
May	114.81	114.88	16.51	16.66	11.2	11.3	72.33	72.10	25.98	26.13
June	113.94	113.73	16.00	16.24	10.5	10.3	72.36	71.67	25.58	25.82
July	115.14	114.42	16.40	16.47	10.5	10.3	72.85	72.08	25.89	25.87
August	115.74	117.04	16.46	16.70	10.6	12.6	73.29	72.77	25.99	27.57
September	116.45	120.23	16.59	16.80	10.7	14.5	73.65	73.22	26.21	30.20
October	116.71	115.72*	16.87	16.84*	10.4	9.6*	73.86	73.64*	25.98	25.24*
November	116.60	117.36	16.80	16.95	10.5	10.2	73.92	74.08	25.88	26.33
December	117.07	117.71	16.71	16.99	10.7	10.1	74.16	74.31	26.20	26.41
January 1986	117.38	117.22	16.85	16.93	10.6	9.8	74.35	74.46	26.18	25.83
February	117.71	117.34	17.10	17.08	10.4	9.7	74.58	74.61	26.03	25.65
March	117.92	117.61	17.13	17.16	10.3	9.8	74.81	74.59	25.98	25.86
April	118.25	118.20	17.27	17.29	10.2	10.0	75.22	74.88	25.76	26.03
May	118.66	118.78	17.46	17.43	10.0	10.0	75.62	75.26	25.58	26.09
June	119.10	119.06	17.40	17.38	10.1	10.1	76.01	75.44	25.69	26.24
July	119.71	119.27	17.39	17.40	10.1	10.0	76.52	75.73	25.80	26.14
August	120.30	119.63	17.48	17.46	10.1	9.9	76.95	76.11	25.87	26.06
September	120.46	119.89	17.64	17.59	10.0	9.8	77.17	76.32	25.76	25.98

Fore. = August Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

CONSTRUCTION

	Housing Starts		Single Family Starts		Housing Permits		Construction Expenditures (Current)		Construction Expenditures (Real)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1985	1.933	1.933	1.155	1.155	1.704	1.704	338.3	341.9	202.9	204.2
May	1.675	1.681	1.041	1.039	1.778	1.778	343.5	339.9	205.7	202.2
June	1.705	1.701	1.027	1.031	1.713	1.712	343.5	343.8	205.3	203.1
July	1.800	1.663	1.072	1.062	1.675	1.694	345.5	340.2	207.1	201.7
August	1.808	1.746	1.095	1.074	1.682	1.784	348.7	344.0	209.4	204.5
September	1.793	1.583	1.118	0.962	1.661	1.796	352.7	348.0*	211.5	206.7*
October	1.806	1.649*	1.126	0.994*	1.668	1.743	353.5	347.0	211.4	205.6
November	1.792	1.746	1.132	1.063	1.643	1.706	355.8	348.3	212.3	205.7
December	1.777	1.748	1.117	1.068	1.629	1.648	358.2	350.3	213.1	206.4
January 1986	1.752	1.765	1.102	1.112	1.582	1.653	357.2	354.8	212.1	208.5
February	1.725	1.717	1.082	1.076	1.565	1.621	357.1	358.2	211.7	210.0
March	1.698	1.666	1.061	1.046	1.569	1.568	357.2	359.1	211.4	209.9
April	1.643	1.633	1.036	1.027	1.542	1.556	355.0	359.6	209.7	209.6
May	1.591	1.649	1.015	1.035	1.496	1.524	354.0	358.9	208.7	208.5
June	1.539	1.626	0.994	1.024	1.483	1.507	352.9	359.0	207.7	208.1
July	1.535	1.629	0.982	1.036	1.442	1.513	351.8	358.7	206.6	207.3
August	1.553	1.637	0.985	1.053	1.435	1.508	350.0	359.2	205.2	207.3
September	1.565	1.642	1.012	1.072	1.443	1.519	348.9	360.2	204.2	207.4

	Non-Residential		Public Construction		Residential Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1985	134.5	135.4	59.3	59.9	144.5	146.5
May	135.7	134.2	61.0	63.5	146.8	142.3
June	135.0	131.8	60.9	64.9	147.6	147.2
July	138.1	131.0	59.9	64.7	147.5	144.5
August	141.4	132.3	59.0	64.4	148.3	147.2
September	144.7	133.5*	59.0	64.8*	149.0	149.7*
October	143.7	134.8	59.7	63.9	150.1	148.3
November	144.3	135.5	60.3	64.5	151.2	148.3
December	145.0	136.4	60.9	65.2	152.3	148.7
January 1986	145.8	137.7	60.5	64.8	150.9	152.3
February	146.6	138.5	60.7	65.4	149.8	154.3
March	147.3	139.3	61.0	65.9	148.9	153.9
April	148.0	140.5	60.5	66.3	146.5	152.8
May	148.7	141.1	61.0	66.7	144.3	151.1
June	149.3	141.7	61.4	67.1	142.2	150.2
July	150.0	142.5	61.5	66.8	140.3	149.4
August	150.3	143.3	61.7	67.2	138.0	148.7
September	150.2	144.0	61.7	67.5	137.0	148.7

Fore. = August Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

BUSINESS ACTIVITY

	Manufacturers' Inventories		Durable Goods Orders		Non-Defense Capital Goods Orders		Non-Defense Capital Shipments	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1985	286.0	286.0	99.73	99.84	25.41	25.46	27.26	27.10
May	285.0	284.9	103.03	102.97	25.64	25.59	26.98	26.81
June	285.0	285.7	104.85	106.78	27.40	27.98	27.00	27.48
July	285.4	285.0	103.05	104.37	26.93	26.69	27.16	27.04
August	286.0	284.6	104.96	107.33	27.45	27.55	27.33	27.79
September	286.7	284.9	103.82	106.11	27.62	28.85	27.50	26.54
October	287.8	285.6*	103.56	106.52*	27.55	28.43*	27.65	27.53*
November	288.7	286.8	104.73	105.92	27.82	26.05	27.85	27.92
December	289.6	288.1	104.25	106.27	27.83	28.23	28.04	28.06
January 1986	290.3	290.0	104.17	105.84	27.54	28.12	28.10	28.15
February	291.5	290.7	103.28	105.53	27.59	27.93	28.00	28.22
March	292.8	291.6	105.43	106.14	28.12	28.07	28.09	28.29
April	294.0	292.5	104.81	106.79	28.10	28.21	28.18	28.35
May	295.3	293.4	105.36	107.05	28.42	28.04	28.27	28.46
June	296.8	294.2	105.15	107.03	28.40	27.92	28.35	28.33
July	298.1	295.1	105.72	106.71	28.63	27.78	28.44	28.46
August	299.5	295.9	105.07	106.84	28.55	27.66	28.52	28.29
September	300.5	296.6	104.96	106.23	28.46	27.41	28.60	28.05

	Business Inventories		Defense Shipments		Industrial Production		Capacity Utilization	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1985	580.2	580.2	6.38	6.35	124.3	124.1	80.9	80.8
May	577.9	577.8	6.59	6.58	124.4	124.1	80.8	80.6
June	577.9	579.7	7.07	7.22	124.6	124.3	80.7	80.5
July	578.8	580.1	7.00	6.83	124.8	124.1	80.7	80.2
August	580.3	577.9	7.03	7.16	125.2	124.8	80.7	80.5
September	581.5	574.2*	7.07	7.07*	125.6	124.7	80.8	80.2
October	583.2	576.3	7.15	7.20	126.2	125.2	81.0	80.4
November	585.1	580.2	7.28	7.12	126.9	125.7	81.3	80.6
December	586.9	583.1	7.42	7.28	127.4	126.1	81.4	80.7
January 1986	589.2	587.4	7.53	7.39	127.4	126.5	81.1	80.8
February	592.0	589.3	7.63	7.52	127.5	126.9	81.0	80.9
March	594.2	591.6	7.75	7.61	127.5	127.3	80.7	80.9
April	596.7	593.7	7.84	7.72	127.6	127.5	80.6	80.8
May	599.3	595.9	7.93	7.95	127.7	127.7	80.5	80.6
June	601.3	597.4	8.01	7.93	127.8	127.8	80.3	80.4
July	603.4	599.8	8.15	8.14	127.8	128.2	80.1	80.5
August	605.9	601.4	8.22	8.16	127.9	128.0	80.0	80.2
September	607.8	602.8	8.30	8.25	128.0	127.8	79.9	79.9

Fore. = August Forecast

C.E. = Current Expectations

* = This item and those beyond it are expectations.

PRICES

	PPI							
	CPI-U		Finished Goods		PPI-Industrial		Estimated GNP	
	(seasonally adjusted)		(seasonally adjusted)		Commodities (unadjusted)		Deflator	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1985	320.4	320.4	293.6	293.6	323.8	323.8	230.23	230.17
May	321.1	321.1	294.2	294.2	325.3	325.3	230.60	230.43
June	321.8	321.8	294.2	293.5	325.2	324.7	231.12	231.05
July	322.6	322.4	294.5	294.4	325.2	324.3	231.75	231.80
August	323.3	323.0	294.3	293.5	324.9	323.6	232.41	232.45
September	324.0	323.6	294.1	291.7	324.0	322.5	233.22	233.07
October	325.0	324.7*	294.8	293.5*	325.7	323.8*	233.84	234.19
November	326.2	325.9	295.3	293.8	326.2	324.2	234.35	235.10
December	327.4	326.5	295.4	294.3	326.6	324.5	234.98	235.72
January 1986	328.6	327.5	296.4	294.9	327.3	325.0	235.90	236.41
February	329.8	328.1	297.2	295.1	328.0	325.4	236.86	236.92
March	331.0	328.8	298.0	294.7	328.7	325.0	237.81	237.44
April	332.5	329.8	298.6	295.5	329.3	325.6	238.54	238.21
May	334.0	331.1	299.1	296.3	329.6	326.1	239.39	239.12
June	335.4	332.4	299.7	296.8	329.9	326.6	240.23	240.03
July	336.3	333.8	300.5	297.4	330.5	327.0	241.11	240.92
August	337.2	334.9	301.6	297.8	332.3	327.6	242.05	241.87
September	338.2	335.8	301.5	298.0	331.1	328.2	242.98	242.91

	Consumption		Consumer		Consumer		Consumer		Implicit	
	Deflator		Durables		Nondurables		Services		Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1985	225.6	225.6	179.2	179.2	221.1	221.1	246.6	246.6	166.7	167.4
May	226.3	226.1	178.5	178.3	221.3	221.1	248.3	248.0	167.0	168.1
June	227.3	227.0	178.1	177.8	220.9	221.3	250.0	249.5	167.3	169.3
July	227.8	227.3	178.6	177.8	221.4	221.7	250.8	250.0	166.8	168.7
August	228.3	227.5	179.4	178.8	221.9	221.7	251.6	251.0	166.5	168.2
September	228.7	227.6*	180.1	179.0*	222.3	222.1*	252.4	251.5*	166.8	168.4*
October	229.5	229.6	180.3	179.9	222.4	223.4	253.6	252.5	167.2	168.8
November	230.3	230.5	180.2	180.6	222.5	224.6	254.8	253.6	167.6	169.3
December	231.1	231.1	180.4	180.8	222.8	225.0	256.0	254.5	168.1	169.7
January 1986	232.0	231.9	180.8	181.1	223.5	225.2	257.1	255.6	168.4	170.2
February	232.9	232.4	181.1	181.4	224.7	224.8	258.2	256.9	168.7	170.6
March	233.8	232.9	181.4	181.7	225.9	224.9	259.3	257.7	169.0	171.1
April	234.6	233.4	181.7	182.0	226.2	225.2	260.6	258.5	169.3	171.6
May	235.5	234.1	181.9	182.3	226.6	225.6	261.8	259.6	169.6	172.1
June	236.4	234.9	182.2	182.5	227.0	226.1	263.0	260.8	169.9	172.5
July	237.3	235.8	182.7	182.7	227.8	226.7	264.2	262.0	170.3	173.0
August	238.2	236.5	183.0	183.0	228.7	227.2	265.4	263.1	170.6	173.3
September	239.1	237.4	183.3	183.4	229.6	227.7	266.6	264.3	170.9	173.7

Fore. = August Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections

MISCELLANEOUS

	Merchandise Trade Balance		Leading Indicators		Estimated GNP		Estimated GNP (1972 \$)		IVA (annual rate)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1985	-11.85	-11.85	166.6	166.9	3842	3842	1669	1669	-1.0	-0.6
May	-12.67	-12.67	167.8	167.4	3853	3852	1671	1672	0.3	2.2
June	-10.99	-13.42	168.5	168.0	3871	3865	1675	1673	4.9	5.3
July	-11.46	-10.51	169.2	168.7	3890	3885	1679	1676	2.2	6.7
August	-12.96	-9.90	169.6	170.1	3912	3921	1683	1687	0.7	6.8
September	-12.95	-11.56	169.3	171.0	3937	3942	1688	1691	1.3	4.8
October	-13.08	-12.05	169.0	171.1	3964	3969	1695	1695	-0.7	2.6
November	-13.17	-12.63	168.4	171.3	3986	3991	1701	1698	-3.4	1.5
December	-12.27	-12.56	168.6	171.9	4008	4014	1706	1703	-6.0	0.3
January 1986	-13.08	-12.69	168.9	171.6	4027	4041	1707	1709	-6.2	0.1
February	-12.96	-12.43	169.3	171.9	4052	4051	1711	1710	-6.9	1.5
March	-12.88	-12.21	168.8	172.2	4076	4072	1714	1715	-5.8	1.9
April	-13.02	-12.46	168.9	171.8	4089	4094	1714	1719	-3.1	1.3
May	-12.99	-12.62	168.2	171.5	4107	4112	1716	1720	-0.8	0.5
June	-12.87	-12.55	167.3	172.2	4124	4130	1717	1721	-1.1	-1.2
July	-12.66	-12.44	167.5	171.6	4145	4152	1719	1723	-4.3	-1.9
August	-12.29	-12.27	167.8	170.9	4167	4167	1722	1723	-5.6	-2.7
September	-12.08	-12.19	168.4	170.8	4190	4189	1724	1724	-6.2	-2.9

Fore. = August Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections

FINANCIAL MARKETS

	Monetary Base		M1		M2		Federal Funds		T-Bills (6 Mos.)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1985	221.9	222.6	574.9	574.9	2427.4	2427.7	8.27	8.27	8.23	8.23
May	223.7	224.0	581.6	581.6	2444.6	2445.0	7.97	7.97	7.65	7.65
June	227.4	227.6	591.1	591.2	2472.8	2473.0	7.53	7.53	7.09	7.09
July	228.3	228.0	595.6	595.8	2495.6	2490.5	7.81	7.88	7.36	7.16
August	229.0	229.3	596.7	605.9	2503.5	2513.7	7.94	7.90	7.44	7.32
September	229.8	231.3	597.9	611.7	2511.2	2528.4	8.07	7.92	7.52	7.27
October	231.3	231.4*	603.6	610.6*	2534.9	2541.0*	8.09	7.96*	7.60	7.40*
November	232.8	232.9	608.8	612.5	2558.0	2556.2	8.27	8.05	7.68	7.53
December	234.2	234.0	614.9	615.4	2582.1	2574.1	8.45	8.23	7.76	7.71
January 1986	235.4	235.1	616.1	617.1	2597.2	2589.5	8.50	8.36	7.85	7.82
February	236.4	236.2	618.7	619.7	2608.3	2607.6	8.53	8.24	7.96	7.67
March	237.4	237.3	620.4	622.2	2619.5	2623.2	8.50	8.43	8.07	7.81
April	238.8	238.5	623.5	624.9	2638.4	2640.3	8.52	8.36	8.01	7.76
May	240.0	239.2	627.3	626.7	2655.3	2656.1	8.43	8.64	7.76	7.93
June	241.3	240.7	631.0	629.4	2672.0	2674.7	8.36	8.53	7.69	7.90
July	242.4	241.6	632.9	631.3	2686.4	2690.7	8.15	8.36	7.60	7.82
August	243.6	242.9	634.6	634.0	2701.2	2706.8	8.02	8.21	7.54	7.73
September	244.7	244.1	636.2	636.6	2716.1	2724.4	7.89	8.05	7.51	7.59

	Aaa (Seasoned)		Municipals (Bond Buyer)		(3 Month) Commercial Paper		90 Day CD's		Prime Rate	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1985	12.23	12.23	9.42	9.42	8.37	8.37	8.49	8.49	10.50	10.50
May	11.72	11.72	8.93	9.01	7.83	7.83	7.92	7.92	10.31	10.31
June	10.94	10.94	8.59	8.69	7.35	7.35	7.44	7.44	9.78	9.78
July	10.85	10.97	8.76	8.81	7.71	7.56	7.86	7.74	9.50	9.50
August	11.06	11.05	9.07	9.13*	7.82	7.72	7.96	7.81	9.50	9.50
September	11.28	11.07	9.31	9.32	7.89	7.83	8.13	7.93	9.50	9.50
October	11.25	11.06*	9.25	9.13	8.02	7.82*	8.17	7.95*	9.50	9.50*
November	11.47	11.23	9.52	9.30	8.15	7.96	8.31	8.07	9.99	9.50
December	11.69	11.42	9.76	9.51	8.38	8.24	8.54	8.38	10.00	9.83
January 1986	11.62	11.55	9.74	9.67	8.51	8.39	8.65	8.52	10.00	10.00
February	11.65	11.36	9.73	9.43	8.55	8.17	8.59	8.26	10.01	10.00
March	11.60	11.46	9.63	9.54	8.46	8.32	8.58	8.41	10.50	10.00
April	11.58	11.35	9.55	9.42	8.40	8.35	8.56	8.52	10.50	10.00
May	11.51	11.52	9.45	9.59	8.27	8.51	8.43	8.67	10.50	10.26
June	11.45	11.49	9.33	9.54	8.18	8.48	8.36	8.59	10.50	10.50
July	11.33	11.27	9.19	9.31	8.03	8.27	8.24	8.38	10.50	10.50
August	11.28	11.13	9.14	9.18	7.96	8.19	8.17	8.29	10.28	10.50
September	11.22	11.06	9.09	8.96	7.90	8.11	8.08	8.25	10.00	10.23

Fore. = August Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

Georgia State University

a unit of the university system of georgia

12/9/85 U1880-3
university plaza
atlanta, georgia 30303

college of business administration
economic forecasting project
404/658-3282

MONTHLY PROJECTIONS NOVEMBER 1985

Dr. Donald Ratajczak, Director
For Release: December 4, 1985

GNP REVISIONS REDUCE INVENTORY REBOUND IN NEXT TWO QUARTERS

Although inventories continue to be lean relative to sales, a surprising increase in retail inventories during September has sharply reduced the inventory deficiency. Apparently, retailers failed to recognize the impact of additional stores upon available retail inventories in their calculations of inventory controls per store. Because of a rapid expansion in retail space and inventories (employment in retail establishments has been growing 1.5 times as rapidly as real retail sales during this expansion), inventories are not as lean as retailers anticipated. However, because they are comfortable with their per store inventory, retailers will blame sluggish consumer activity for their failure to meet budgeted amounts during the Christmas season. They are likely to try non-price sales efforts, such as extended hours, free gift wrap, and the like until Christmas. Then, significant post Christmas promotions are anticipated in order to remove the excess inventories.

The surge in retail inventories in September was largely responsible for the upward revision in inventory investment in the third quarter GNP. That upward adjustment also was primarily responsible for the upward adjustment in estimated GNP. Because inventories turn over more rapidly than other goods, the price deflator for inventories is substantially lower than the price index for other GNP components. Therefore, an upward revision in inventory investments leads to a downward revision in the GNP deflator as a result of a shift in the composition of GNP expenditures. On a fixed-weighted basis, inflation as measured by the GNP actually increased slightly during the third quarter. (The surge in automobile sales in August and September also flattened the GNP deflator, because automobile expenditures are based upon a lower implicit deflator than other GNP components. The sag in auto sales during the fourth quarter will reverse this composition change. Thus, the GNP deflator will be growing more than the fix-weighted index would anticipate during that quarter. Indeed, a surge in the deflator to more than 4%, while not anticipated here, could materialize.)

Because retailers are not yet aware that they have an inventory problem, the upward revisions during the third quarter will have only a modest impact upon restraining production in the fourth quarter. Early in 1986, however, reduced orders by retailers and some production adjustments in the automobile industry, where sales currently are trailing production by nearly 1.5 million units, will cause some significant slowing in industrial growth. By the second quarter, a minor rebound in consumer spending along with continued strength in construction should cause a slight spurt in economic activity. Oil prices also are expected to fall at that time. By the end of 1986, however, the declining dollar should begin to have some inflationary impact. In addition, net exports should begin improving, leading to positive contributions to economic activity. Consumer spending is expected to be modest, but positive, at that time. However, construction is expected to trend downward. In addition, capital spending is expected to show minimal growth. This explains the relatively sluggish performance during the latter part of 1986.

A sharp rebound in shipments of durable goods during October suggests that government spending for defense products will rise sharply in the fourth quarter. However, shipments were strong because of special aircraft deliveries; thus, a slump in shipments is anticipated early in 1986. Commercial aircraft shipments also were responsible for much of the sharp increase in shipments of nondefense capital goods. It is possible that these results are caused by reporting errors in that sector. However, if the data are not adjusted, substantial gains in fixed investment will develop in the fall followed by minimal expansion during the winter. Because the shipments of durables goods were not consistent with durable goods production as measured by the industrial production index in October, either that index will be revised upward or most of those shipments were at the expense of manufacturer's inventories. If the manufacturing report does not show a significant decrease in inventories of durable goods during October then some faulty data problems must account for the surprising shipment gains.

As expected, corporate profits rebounded sharply during the third quarter. Although some of this gain was the result of improved economic activity, most of the increase in profitability was caused by a reduction in interest payments. Returns to capital do not appear to be unusually robust. Indeed, those returns are expected to diminish slightly in the next few quarters. However, the percentage of those capital earnings available for equity holders has been increasing as interest rates have fallen. Because of more significant lags in adjusting interest costs for changes in interest rates than previously prevailed, these reductions in interest costs are anticipated until the first quarter of 1986. As a result, earnings on equity will be surprisingly robust through the remainder of this year. Some weakness in those earnings then is expected to materialize early in 1986. If this pattern holds, equity values can continue to move higher through the fourth quarter. They then must recognize the difficulties associated with corporate earnings early in 1986. The stock market then would be susceptible to weakness. This weakness would be especially dramatic if interest rates began pressing upward, as we anticipate early in 1986.

Although short-term interest rates have remained remarkably stable over the past six months, long-term interest rates have declined significantly. During much of this period, investors apparently believed that an economic rebound could lead to higher interest rates ahead. Early in November, however, investors began to believe that the economy was sluggish. As a result, short-

term interest rates could decline further. With long-term government bonds yielding more than the prime rate and with anticipations that interest rates could fall, smart investors accumulated long-term government bonds to benefit from the favorable spread between bond yields and the cost of holding bond inventories and to capture any price appreciation that would result from declining short-term rates. Under such conditions, long-term government yields could decline to the prime rate. However, our projections suggest that some slight upward pressures will develop for short-term interest rates in the next few months. This risk of higher carrying costs to hold bond inventories should discourage investors from maintaining their speculative positions. Therefore, government yields probably will rise about a half percentage point above the prime rate in the middle months of 1986. However, declining rates thereafter could once again establish profitable opportunity for bond investor in the second half of that year.

Economic Impact of Tax Reform

Although tax reform remains a longshot for 1986, the tax bill passed by the Ways and Means Committee established some ground rules for evaluating the next tax code change that may materialize.

Several principles appear to be developing: first, second homes will be treated the same as primary residences for tax purposes. This should improve the investment prospect of such assets. Second, repeal of the investment tax credit and more stringent depreciation guidelines will be the primary sources of raising revenues in order to reduce marginal tax rates for corporations and individuals. Third, both corporations and individuals will be subject to more stringent minimum tax rules in determining their tax liabilities. Fourth, most employer-provided benefits will remain tax deductible although unemployment insurance will become taxable.

Some economists maintain that this shift in the tax burden from the consumer sector to the corporate sector will reduce gross savings in the economy. This certainly appears to be an obvious consequence of the tax reform proposal. In addition, some economists maintain that continuing the macroeconomic objectives of the Federal Reserve would require higher interest rates to preserve the same level of expenditures and inflation with these reduced savings. However, such analysis fails to recognize that changes in the investment tax credit and in accelerated depreciation may reduce desired investment expenditures by a larger amount than the reduction in potential gross savings. Under such circumstances, interest rates could actually fall, a condition that we are generating in our analysis of the tax proposals.

Of course, some other economists recognize that the change in the investment tax credit and depreciation will adversely impact investment decisions. They conclude, therefore, that economic growth will slow. While this is possible, and certainly would be the case if interest rates increased, the proposals generally narrow the tax discrepancy between earnings generated by labor and capital resources. To the extent that tax benefits were especially generous for capital investment, leading to inefficient capital intensity, the adjusted tax code could generate increased total factor productivity and additional growth. Ideally, the adjustments will eliminate the construction of vacant buildings in Houston while having minimal impact upon constructing productive plants in Ohio. Indeed, if the inefficient capital intensity was substantial,

the declining interest cost associated with reduced investment activity could more than offset the increased tax liability facing productive capital resources. In that circumstance, the accumulation of efficient capital could increase, leading to more growth. Again, our analysis suggests that the proposal would raise total factor productivity, leading to increased growth over time.

For the above reasons, the tax proposals appear to be slightly beneficial for the allocation of resources over time.

Quarterly Profile of GNP

	<u>1985-3</u>	<u>1985-4</u>	<u>1986-1</u>	<u>1986-2</u>	<u>1986-3</u>	<u>1986-4</u>
Real:	4.3	3.1	2.6	3.3	2.1	2.0
Price:	2.3	3.7	4.2	3.6	4.4	4.2
Nominal:	6.7	6.9	7.0	7.1	6.6	6.4

Monthly Statistical Highlight for November 1985

Payroll employment +177,000; index of hours worked +0.2%; household employment +238,000; civilian unemployment rate 7.1%; personal income +0.4%; savings rate 2.8%; personal consumption +0.6%; retail sales +0.5%; auto sales 9.7 million; housing starts -0.7%; housing permits -1.9%; construction expenditures +0.7%; business inventory +0.3%; orders for durable goods +1.7%; orders for nondefense capital goods +2.8%; industrial production +0.3%; CPI +0.5%; PPI +0.3%; consumption deflator +0.3%; leading indicators +0.5%; real GNP +2.1%; M1 +5.6%; M2 +5.6%.

Monthly Statistical Highlight for December 1985

Payroll employment +311,000; index of hours worked +0.3%; household employment +388,000; civilian unemployment rate 6.9%; personal income +0.7%; savings rate 2.9%; personal consumption +0.5%; retail sales +0.4%; auto sales 9.6 million; housing starts -2.9%; housing permits -2.1%; construction expenditures +0.4%; business inventory +0.3%; orders for durable goods +0.5%; orders for nondefense capital goods +0.3%; industrial production +0.2%; CPI +0.3%; PPI +0.3%; consumption deflator +0.4%; leading indicators +0.1%; real GNP +2.9%; M1 +6.2%; M2 +8.8%.

COMMENTARY

Employment - The failure of the industrial production index to confirm the rapid payroll employment gains in October suggests that some distortions may have been present in the report. Apparently, the September report was unusually early in the month while the October report was unusually late. This may have created a greater increase in employment than actually occurred on a monthly basis. If so, much weaker employment growth should be anticipated for November even as the production index begins to rebound. In addition, the workweek probably has reached a high plateau for this cycle. Therefore, growth in the index of hours

worked should correspond more closely to growth in payroll employment than in the past two years.

Personal Income - Rental income continues to be adversely impacted by hurricane damage in the October and November reports. The degree of decline in October should be only half as large as in September before the November hurricanes once again sharply dampened personal income. Because of a rebound in farm prices, farm income should positively add to personal income in the next two months. On the other hand, it appears that the lagged impact of interest rate changes upon interest income has increased. Apparently, a larger segment of the earned income is contained in savings certificates. As these certificates mature, they will be replaced by certificates with lower yields. Until this rotation to lower yields ends, the interest component will continue to sag.

Our projections continue to contain unusually low savings rates. Some of this reflects the impact from charges to rental income as a result of hurricane damage. As a result of the hurricanes, there will be reduced savings both when personal repairs are made and also when the damage is assessed. In the one case, expenditures are increased while incomes are reduced to reflect casualty losses.

Construction - Housing starts in October remained relatively low in comparison to permits as the construction of rental property continues to lag the issuance of rental property permits. Tax uncertainty continues to be a factor in causing a discrepancy between starts and permits. Such a discrepancy is expected to continue into the early months of 1986. We currently feel that the permits will gradually become more appropriately realigned with starts after that time.

Construction expenditures were revised sharply downward in October to reflect more appropriate information on nonresidential private construction. This area remains relatively sluggish as a result of diminishing utility construction. On the other hand, residential construction is more vigorous than previously expected.

Business Activity - As mentioned above, a discrepancy developed between shipments of durable goods and industrial production in the durable goods industry. If this data is correct, then manufacturing inventories should decline in October. We are not yet willing to show such a decline, but such an outcome would lead to slightly lower fourth quarter GNP estimates than currently presented. We also are concerned with the sharp rebound in both defense and non-defense shipments as a result of significant deliveries of aircraft. These should develop at the expense of inventories of goods and processing leading to declining manufacturing inventory, but this remains to be seen.

Prices - The sharp increase in automobile sales led to a favorable composition restraint upon the consumption deflator in August and September. Because sales slumped so sharply in October, the composition shift will be adverse in that month. In addition, sharp increases are developing for the CPI because of significant price increases for meats. On the other hand, construction costs continue to show minimal change. This factor has led to a downward revision in our estimates of the GNP deflator during the next year.

Miscellaneous - Because of the reporting problems associated with the merchandise trade accounts, we are using a three-month moving average to adjust our estimates of current trade flows. This averaging technique probably is

generating some distortions in our monthly movements of economic activity. However, failure to smooth the merchandise trade balance would create unseemly fluctuations in monthly GNP that could not be rectified with employment and production data.

The inventory valuation adjustment showed a sharper improvement than originally anticipated. Apparently, falling prices for energy material through September created a significant portion of this favorable result. As those energy material prices are no longer favorable, the favorable IVA should gradually diminish.

FINANCIAL MARKETS

Money growth continues to exceed anticipations even though the monetary base has not been growing as vigorously as expected. This rapid increase in the money multiplier, to a record 2.67 in recent weeks, cannot be fully explained. In the last few weeks an increase in the federal funds rate suggests that growing money demand is partially responsible for this sharp increase in the money multiplier. However, technical distortions also must be present. In addition to the M1 distortions, favorable conditions in the equity markets have sharply reduced the growth of money market funds. This is having an adverse effect upon the growth of M2.

Apparently, the absence of government supply in the bond market had minimal effect upon bond prices in recent weeks. Indeed, a feeling that the discount rate may decline caused many bond traders to accumulate an increasing inventory of government securities. This caused yields of long-term government securities to converge toward the prime rate. If the prime rate rises in the next few months, as we anticipate, this flattening of the yield curve will be overdone. As a result, interest rates probably will rise for long-term instruments in the next few months. Similarly, the rally in the municipals market should come to an end. The tax reform package has not reduced the supply of tax exempt bonds as much as the President's proposal had desired. At the same time, the marginal tax rate is slightly higher in the Ways and Means proposal than in the President's program. In addition, banks believe that provisions that would deny the deductibility of interest expense against tax exempt bond portfolio will significantly reduce the attractiveness of those bonds for banks. Indeed, tax exempt instruments that are issued in January are selling at a .4 percentage point higher yield than those currently available and subject to the present tax code. This suggests that a vulnerability of at least a half percentage point, for the discrepancy must also adjust for probabilities that no tax reform will be forthcoming, appear to be facing tax exempt investors.

Equity Markets - Improvement in returns to equity holders and declining interest rates have been a one/two combination that clearly encourages higher equity values. If the bond market begins to retrench, equity earnings will need to grow dramatically to preserve current equity values. Some further increases in equity values appear likely through the end of 1985. However, the market then would be vulnerable to decline early in 1986.

EMPLOYMENT

	Payroll Employment		Index of Hours Worked		Household Civilian Employment		Civilian Unemployment Rate		Hourly Earnings Index	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1985	97707	97707	116.0	116.0	106862	106862	7.3	7.3	165.4	165.4
August	97987	97977	116.7	116.7	107172	107172	7.0	7.0	165.6	165.7
September	98115	98115	117.2	116.9	107544	107544	7.1	7.1	165.6	166.6
October	98496	98529	117.5	117.3	107853	107867	7.1	7.1	166.3	166.7
November	98823	98706*	117.7	117.5*	108196	108105*	7.1	7.1*	167.0	167.2*
December	99146	99017	118.0	117.9	108539	108493	7.0	6.9	167.7	167.6
January 1986	99301	99253	118.3	118.1	108716	108682	6.9	6.9	168.3	168.1
February	99422	99407	118.5	118.3	108893	108890	6.8	6.9	168.7	168.7
March	99545	99558	118.7	118.5	109070	109030	6.7	6.9	169.2	169.2
April	99764	99713	118.9	118.6	109283	109237	6.7	7.0	169.8	169.8
May	99981	99876	119.1	118.8	109516	109452	6.7	7.0	170.3	170.3
June	100198	100023	119.3	119.0	109782	109639	6.8	7.0	170.9	170.9
July	100306	100175	119.4	119.1	109913	109827	6.7	7.0	171.4	171.5
August	100417	100339	119.5	119.3	110029	110043	6.7	6.9	171.9	172.0
September	100529	100503	119.5	119.5	110142	110265	6.8	6.9	172.5	172.6
October	100683	100681	119.7	119.7	110316	110453	6.7	7.0	172.9	173.2
November	100840	100858	119.9	119.9	110548	110683	6.7	6.9	173.3	173.9
December	100997	101014	120.2	120.1	110780	110871	6.7	7.0	173.8	174.5

PERSONAL INCOME

	Personal Income		Wage & Salary		Personal Savings		Disposable Income		Personal Outlays	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1985	3.189	3.188	1.923	1.923	104.0	98.7	2.707	2.707	2.603	2.608
August	3.199	3.196	1.934	1.933	79.2	74.2	2.713	2.710	2.634	2.636
September	3.209	3.207	1.949	1.945	51.9	48.6	2.717	2.716	2.665	2.667
October	3.225	3.221	1.960	1.953	83.1	80.3	2.730	2.725	2.647	2.645
November	3.254	3.235*	1.972	1.963*	91.2	75.8*	2.755	2.736*	2.664	2.660*
December	3.279	3.257	1.985	1.976	92.2	79.5	2.777	2.755	2.685	2.675
January 1986	3.290	3.271	1.997	1.986	89.5	73.3	2.789	2.766	2.699	2.693
February	3.310	3.291	2.006	1.998	93.0	82.6	2.804	2.783	2.711	2.700
March	3.332	3.309	2.015	2.008	99.9	85.9	2.820	2.798	2.720	2.712
April	3.349	3.327	2.026	2.019	97.6	85.4	2.834	2.813	2.736	2.728
May	3.365	3.344	2.036	2.029	92.6	86.7	2.847	2.827	2.754	2.740
June	3.381	3.364	2.047	2.042	89.5	87.5	2.859	2.844	2.769	2.757
July	3.397	3.381	2.054	2.052	92.5	86.7	2.872	2.858	2.780	2.771
August	3.412	3.398	2.062	2.063	90.7	87.2	2.883	2.872	2.792	2.785
September	3.428	3.418	2.070	2.075	89.4	88.4	2.896	2.888	2.807	2.800
October	3.443	3.438	2.079	2.088	83.0	88.7	2.907	2.905	2.824	2.816
November	3.459	3.458	2.090	2.101	77.1	91.0	2.920	2.922	2.843	2.831
December	3.475	3.479	2.102	2.114	74.8	90.8	2.933	2.939	2.858	2.848

Fore. = November Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

CONSUMPTION

	Personal Consumption		Durables		Nondurables		Services		Consumption Real	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1985	2506.9	2511.3	336.9	336.9	892.1	892.1	1277.9	1282.2	1103.1	1104.1
August	2536.1	2538.0	357.4	357.7	893.6	895.4	1285.1	1284.9	1114.8	1116.6
September	2566.6	2567.6	372.5	375.6	901.1	903.0	1292.9	1288.9	1127.7	1128.9
October	2546.9	2544.2	338.9	335.6	906.3	911.5	1301.7	1297.1	1112.2	1111.1*
November	2562.2	2559.3*	340.5	338.0*	911.1	916.0*	1310.6	1305.3*	1114.5	1113.7
December	2581.7	2573.3	342.1	337.6	916.2	921.3	1323.4	1314.4	1118.6	1115.6
January 1986	2595.5	2589.5	342.3	340.0	920.7	927.9	1332.5	1321.6	1121.7	1119.7
February	2606.1	2596.2	343.0	340.3	923.5	925.8	1339.6	1330.1	1122.8	1119.4
March	2614.3	2607.0	342.5	340.2	924.5	927.4	1347.3	1339.4	1122.5	1120.6
April	2629.3	2621.6	344.7	341.4	927.8	931.4	1356.8	1348.8	1126.0	1124.0
May	2645.8	2633.4	346.3	340.4	933.2	935.3	1366.3	1357.7	1129.7	1125.6
June	2659.5	2648.6	344.9	341.4	938.9	939.7	1375.7	1367.5	1131.7	1128.4
July	2668.4	2662.5	344.1	343.4	939.7	942.5	1384.6	1376.6	1130.7	1130.8
August	2680.1	2675.1	344.4	343.9	940.4	945.7	1395.3	1385.5	1131.3	1132.2
September	2693.3	2689.0	345.9	345.2	941.4	948.6	1406.0	1395.2	1132.6	1134.3
October	2709.4	2704.8	346.8	348.5	947.8	951.6	1414.8	1404.7	1135.1	1137.8
November	2727.0	2718.4	348.6	350.2	954.2	954.7	1424.2	1413.5	1138.6	1139.7
December	2741.0	2734.5	350.1	352.9	957.3	958.8	1433.6	1422.8	1140.7	1142.8

RETAIL SALES

	Retail Sales		Non-Auto Durables		Auto (Million Units)		Nondurable Sales		Auto Sales	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1985	114.42	114.42	16.47	16.47	10.3	10.3	72.08	72.08	25.87	25.87
August	117.04	116.98	16.70	16.82	12.6	12.6	72.77	72.70	27.57	27.46
September	120.23	119.41	16.80	16.79	14.5	14.5	73.22	72.96	30.20	29.67
October	115.85	115.51	16.84	17.43	9.8	9.6	73.68	72.76	25.33	25.33
November	115.91	116.06*	16.90	17.25*	9.9	9.7*	74.05	73.28*	24.96	25.53*
December	115.88	116.47	16.96	17.32	10.1	9.6	74.14	73.70	24.78	25.42
January 1986	116.68	117.27	17.01	17.39	9.9	9.7	74.58	74.23	25.09	25.65
February	117.26	117.73	17.08	17.35	9.9	9.7	75.13	74.66	25.05	25.72
March	117.23	117.85	17.15	17.38	9.8	9.6	75.01	74.79	25.07	25.68
April	117.89	118.32	17.25	17.46	9.8	9.6	75.49	75.11	25.15	25.75
May	118.27	118.52	17.20	17.50	9.9	9.5	75.75	75.43	25.32	25.59
June	118.55	118.99	17.20	17.45	9.9	9.6	76.02	75.78	25.33	25.76
July	118.60	119.75	17.28	17.59	9.7	9.7	76.28	76.01	25.04	25.88
August	118.87	119.80	17.35	17.71	9.6	9.7	76.46	76.27	25.06	25.82
September	118.59	120.20	17.20	17.66	9.5	9.8	76.30	76.50	25.09	26.04
October	119.45	120.86	17.32	17.69	9.5	9.8	76.86	76.74	25.27	26.43
November	120.25	121.32	17.45	17.78	9.6	9.8	77.36	76.99	26.44	26.55
December	120.95	121.99	17.46	17.84	9.7	9.9	77.89	77.32	25.60	26.83

Fore. = November Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

CONSTRUCTION

	Housing Starts		Single Family Starts		Housing Permits		Construction Expenditures (Current)		Construction Expenditures (Real)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1985	1.663	1.663	1.062	1.062	1.694	1.694	340.2	344.8	201.7	204.4
August	1.746	1.740	1.074	1.059	1.784	1.784	344.0	344.7	204.5	204.9
September	1.583	1.589	0.962	0.970	1.796	1.804	348.0	346.1	206.7	205.8
October	1.685	1.760	1.003	1.123	1.741	1.675	348.3	347.8	206.0	206.7
November	1.723	1.748*	1.058	1.094*	1.683	1.643*	349.0	350.1*	205.3	207.5*
December	1.734	1.697	1.065	1.056	1.675	1.608	350.9	351.4	205.3	207.7
January 1986	1.708	1.727	1.025	1.065	1.638	1.611	352.2	352.7	205.5	207.7
February	1.695	1.763	1.027	1.080	1.563	1.634	354.9	352.9	206.6	207.2
March	1.691	1.777	1.053	1.123	1.558	1.659	357.6	353.4	207.8	206.9
April	1.708	1.759	1.046	1.117	1.569	1.668	359.2	356.6	207.9	208.1
May	1.713	1.711	1.057	1.088	1.583	1.619	360.5	358.6	207.9	208.6
June	1.649	1.709	1.065	1.102	1.542	1.598	362.1	359.2	208.1	208.5
July	1.628	1.656	1.053	1.093	1.497	1.563	362.9	360.2	208.0	208.4
August	1.615	1.600	1.058	1.057	1.483	1.527	363.4	359.4	207.7	207.4
September	1.603	1.597	1.046	1.070	1.480	1.508	364.0	358.9	207.4	206.4
October	1.583	1.593	1.050	1.078	1.472	1.496	362.2	359.0	205.7	205.8
November	1.587	1.631	1.051	1.099	1.483	1.524	360.4	359.4	203.8	205.5
December	1.618	1.666	1.063	1.122	1.491	1.546	360.9	360.9	203.3	205.8

	Non-Residential		Public Construction		Residential Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1985	131.0	131.1	64.7	64.5	144.5	149.2
August	132.3	132.4	64.4	64.0	147.2	148.3
September	133.5	133.7	64.8	63.4	149.7	149.0
October	135.0	132.4	65.0	64.0	148.3	151.4
November	136.6	133.6*	64.8	64.3*	147.6	152.2*
December	138.1	134.8	64.9	64.5	147.9	152.1
January 1986	139.0	135.2	63.9	64.5	149.3	153.0
February	140.1	135.9	64.0	64.6	150.8	152.4
March	141.2	136.3	64.2	64.7	152.2	152.4
April	142.2	137.2	65.0	65.0	152.0	154.4
May	143.1	138.3	66.1	65.4	151.3	154.9
June	144.0	138.9	67.3	65.7	150.8	154.6
July	144.7	139.5	67.7	66.3	150.5	154.4
August	145.3	140.0	68.1	66.8	150.0	152.6
September	145.8	140.6	68.6	67.2	149.6	151.1
October	146.0	141.5	67.9	67.7	148.3	149.8
November	146.2	142.3	66.8	68.0	147.4	149.1
December	146.2	143.0	67.2	68.2	147.5	149.7

Fore. = November Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

BUSINESS ACTIVITY

	Manufacturers' Inventories		Durable Goods Orders		Non-Defense Capital Goods Orders		Non-Defense Capital Shipments	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1985	285.0	285.0	104.37	104.37	26.69	26.69	27.04	27.04
August	284.6	284.7	107.33	107.66	27.55	27.55	27.79	27.79
September	284.9	284.2	106.11	106.64	28.85	29.24	26.54	26.72
October	285.2	284.8*	105.58	104.45	28.26	27.09	27.25	27.80
November	285.9	285.5	105.03	106.23*	28.11	27.85*	27.39	27.59*
December	286.5	286.1	105.46	106.74	28.42	27.92	27.54	27.83
January 1986	287.7	286.9	107.19	107.64	28.93	28.15	27.81	27.96
February	289.0	288.0	107.63	108.01	29.06	28.31	27.93	28.04
March	290.1	289.2	104.85	107.43	27.62	27.82	27.76	28.01
April	291.6	290.5	104.99	106.97	27.95	27.96	28.04	28.23
May	292.9	291.8	106.27	108.46	28.36	28.43	28.36	28.49
June	294.3	293.1	107.73	109.13	28.53	28.61	28.70	28.58
July	295.8	294.2	108.82	109.27	28.75	28.77	28.86	28.72
August	297.5	295.3	108.51	109.82	28.92	28.84	28.55	28.81
September	298.9	296.1	107.65	109.07	28.68	28.69	28.67	28.93
October	300.2	297.2	106.93	108.83	28.62	28.75	28.95	29.04
November	301.7	298.5	105.88	108.46	28.51	28.63	29.10	29.08
December	303.0	299.8	106.27	108.21	28.68	28.60	29.19	29.05

	Business Inventories		Defense Shipments		Industrial Production		Capacity Utilization	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1985	580.1	580.1	6.83	6.83	124.1	124.1	80.2	80.2
August	577.9	578.2	7.16	7.16	124.8	125.0	80.5	80.6
September	574.2	579.5	7.07	7.13	124.7	124.9	80.2	80.4
October	576.3	580.7*	7.15	7.71	125.1	124.9	80.3	80.2
November	577.8	582.2	7.21	7.28*	125.7	125.3*	80.5	80.3*
December	579.1	584.0	7.25	7.33	126.2	125.5	80.6	80.3
January 1986	581.6	585.3	7.36	7.35	126.7	125.6	80.8	80.1
February	584.3	586.9	7.47	7.46	127.1	125.9	80.9	80.2
March	587.1	588.8	7.60	7.63	127.8	126.2	81.1	80.3
April	590.0	591.0	7.71	7.70	128.0	126.2	81.0	80.1
May	592.8	593.6	7.75	7.79	127.8	126.4	80.7	80.1
June	595.7	596.1	7.77	7.84	127.6	126.5	80.4	80.0
July	598.4	600.3	7.89	7.92	127.4	126.3	80.1	79.7
August	601.3	602.7	8.01	8.05	127.2	126.4	79.8	79.6
September	604.4	604.8	8.10	8.14	127.2	126.5	79.6	79.5
October	607.6	607.9	8.18	8.20	127.1	126.8	79.3	79.6
November	610.5	610.8	8.27	8.31	127.1	126.9	79.1	79.5
December	613.4	614.3	8.36	8.43	127.0	127.0	78.8	79.4

Fore. = November Forecast

C.E. = Current Expectations

* = This item and those beyond it are expectations.

PRICES

	PPI							
	CPI-U		Finished Goods		PPI-Industrial		Estimated GNP	
	(seasonally adjusted)		(seasonally adjusted)		Commodities (unadjusted)		Deflator	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1985	322.4	322.4	294.4	294.4	324.3	324.3	231.80	231.66
August	323.3	323.0	293.5	293.5	323.6	323.6	232.45	231.93
September	324.2	323.6	291.7	291.7	322.5	322.5	233.07	231.96
October	325.3	324.6	293.6	294.4	324.3	324.4	234.18	233.22
November	326.5	326.2*	294.8	295.4*	324.5	325.4*	234.76	234.07
December	327.7	327.2	295.6	296.3	324.7	325.6	235.46	234.99
January 1986	328.6	328.2	296.1	297.1	325.0	325.9	236.35	235.68
February	329.5	329.1	297.0	297.8	324.5	325.5	237.30	236.36
March	330.4	330.1	297.8	298.2	324.6	325.1	238.04	236.12
April	331.9	330.9	298.5	298.5	325.0	325.5	238.72	237.78
May	333.3	332.1	299.3	299.0	325.9	326.2	239.64	238.54
June	334.8	333.1	300.1	299.6	326.8	327.1	240.56	239.35
July	335.9	334.2	300.7	300.2	327.0	327.6	241.50	240.14
August	337.1	335.4	301.5	300.9	327.9	328.3	242.42	241.06
September	338.3	336.5	302.0	301.4	326.2	326.5	243.34	241.97
October	339.5	337.5	303.1	301.8	328.6	329.2	244.17	242.74
November	340.7	338.7	303.9	302.4	328.8	330.0	245.06	243.62
December	341.9	339.8	304.4	303.0	329.1	330.4	245.95	244.46

	Consumption		Consumer		Consumer		Consumer		Implicit	
	Deflator		Durables		Nondurables		Services		Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1985	227.3	227.5	177.8	177.8	221.7	221.7	250.0	250.4	168.7	168.7
August	227.5	227.3	178.8	178.3	221.7	221.4	251.0	251.2	168.2	168.2
September	227.6	227.4	179.1	178.3	222.0	222.1	251.9	252.0	168.3	168.2
October	229.0	229.0*	177.8	177.5*	222.9	222.8*	252.9	252.9*	169.1	168.3*
November	229.9	229.8	178.0	177.8	223.9	223.8	254.0	253.8	170.0	168.7
December	230.8	230.7	178.2	178.1	224.8	224.7	254.8	254.7	170.9	169.2
January 1986	231.4	231.3	178.4	178.4	225.2	225.1	255.9	255.7	171.4	169.8
February	232.1	231.9	178.6	178.6	225.6	225.5	257.0	256.6	171.8	170.3
March	232.9	232.6	178.9	178.9	225.8	225.7	258.1	257.8	172.1	170.8
April	233.5	233.2	179.1	179.2	226.3	226.1	259.1	258.6	172.8	171.4
May	234.2	234.0	179.3	179.5	226.8	226.5	260.2	259.6	173.4	171.9
June	235.0	234.7	179.5	179.8	227.4	227.0	261.3	260.7	174.0	172.3
July	236.0	235.5	179.8	180.1	228.0	227.5	262.7	261.8	174.5	172.8
August	236.9	236.3	180.1	180.4	228.6	228.1	264.0	262.9	175.0	173.3
September	237.8	237.1	180.4	180.7	229.2	228.7	265.3	264.0	175.5	173.9
October	238.7	237.7	180.8	181.0	229.8	229.3	266.4	264.9	176.1	174.4
November	239.5	238.5	181.2	181.4	230.4	229.9	267.5	266.0	176.8	174.9
December	240.3	239.3	181.5	181.8	231.0	230.5	268.6	267.1	177.5	175.4

Fore. = November Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

MISCELLANEOUS

	Merchandise Trade Balance		Leading Indicators		Estimated GNP		Estimated GNP (1972 \$)		IVA (annual rate)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1985	-10.51	-10.51	168.7	168.7	3885	3889	1676	1679	6.7	6.7
August	-9.90	-9.90	170.1	170.2	3921	3924	1687	1692	6.8	6.8
September	-11.50	-15.50	171.0	170.3	3942	3934	1691	1696	4.8	9.0
October	-10.68	-11.47	171.1	170.6*	3967	3959	1694	1698	2.2	7.3
November	-10.92	-11.93*	171.3	171.4	3992	3981	1700	1701	-3.5	5.6
December	-11.16	-12.65	171.9	171.6	4016	4007	1706	1705	-6.5	3.5
January 1986	-11.01	-11.84	171.6	170.9	4043	4025	1711	1708	-3.6	0.9
February	-11.96	-11.69	171.9	170.5	4067	4048	1714	1713	-0.9	1.6
March	-11.44	-11.73	172.2	171.0	4101	4072	1723	1717	0.5	2.7
April	-10.27	-11.42	171.8	171.4	4122	4095	1727	1722	1.2	3.5
May	-11.46	-10.98	171.5	170.8	4144	4118	1729	1727	2.1	3.8
June	-12.21	-10.72	172.2	170.3	4157	4142	1728	1731	1.8	3.1
July	-9.73	-10.63	171.6	169.5	4176	4166	1729	1735	0.5	2.4
August	-11.48	-10.15	170.9	169.2	4197	4183	1731	1735	-3.6	1.7
September	-11.32	-9.97	170.8	169.6	4218	4203	1733	1737	-6.5	0.8
October	-11.20	-10.15	170.3	169.4	4239	4226	1736	1741	-6.5	-2.4
November	-10.96	-9.71	170.9	170.0	4262	4250	1739	1744	-7.3	-2.9
December	-10.04	-9.53	171.3	170.5	4286	4273	1743	1748	-7.8	-4.2

Fore. = November Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

FINANCIAL MARKETS

	Monetary Base		M1		M2		Federal Funds		T-Bills (6 Mos.)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1985	228.0	227.9	595.8	595.8	2490.5	2490.6	7.88	7.88	7.16	7.16
August	229.3	229.4	605.9	606.0	2513.7	2514.0	7.90	7.90	7.32	7.32
September	231.3	231.6	611.7	611.9	2528.4	2528.7	7.92	7.92	7.42	7.27
October	231.7	231.2	610.5	611.3	2540.5	2533.4	7.95	7.99	7.40	7.33
November	232.8	232.6*	612.6	614.1*	2557.1	2545.0*	8.15	7.89*	7.58	7.28*
December	234.0	233.8	615.3	617.2	2573.6	2562.9	8.29	8.02	7.64	7.36
January 1986	235.4	235.1	619.1	620.2	2590.4	2580.5	8.25	8.05	7.66	7.38
February	236.8	236.3	622.3	622.7	2606.8	2596.1	8.36	8.16	7.79	7.53
March	238.1	237.7	625.3	625.9	2623.2	2614.6	8.50	8.23	7.92	7.56
April	239.3	238.6	628.2	627.5	2640.4	2629.1	8.59	8.20	7.98	7.52
May	240.5	240.0	630.6	631.2	2655.2	2647.9	8.55	8.22	7.95	7.48
June	241.7	241.1	633.0	632.9	2667.3	2661.0	8.42	8.17	7.86	7.43
July	243.0	242.4	635.0	635.1	2682.5	2673.6	8.26	8.06	7.74	7.27
August	244.3	243.6	637.9	637.7	2700.3	2690.6	8.12	7.93	7.63	7.15
September	245.6	245.0	640.8	640.7	2719.6	2706.7	8.01	7.76	7.46	7.12
October	247.0	246.3	644.4	644.1	2738.5	2727.3	7.86	7.62	7.45	7.08
November	248.3	247.5	648.3	646.7	2755.0	2744.6	7.71	7.43	7.43	7.03
December	249.6	248.8	650.7	649.4	2772.1	2759.6	7.59	7.18	7.41	6.87

	Aaa (Seasoned)		Municipals (Bond Buyer)		(3 Month) Commercial Paper		90 Day CD's		Prime Rate	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1985	10.97	10.97	8.81	8.81	7.56	7.56	7.74	7.74	9.50	9.50
August	11.05	11.05	9.13	9.08	7.72	7.72	7.81	7.81	9.50	9.50
September	11.07	11.07	9.32	9.32*	7.83	7.83	7.93	7.93	9.50	9.50
October	11.08	11.02	9.25	8.96	7.82	7.80	7.90	7.88	9.50	9.50
November	11.20	10.54*	9.30	8.53	8.16	7.73*	8.26	7.83*	9.50	9.50*
December	11.38	10.31	9.36	8.25	8.30	7.86	8.42	7.98	9.50	9.50
January 1986	11.40	10.35	9.39	8.30	8.14	8.03	8.27	8.15	9.88	9.50
February	11.46	10.53	9.46	8.49	8.35	8.20	8.49	8.31	10.00	9.78
March	11.51	10.69	9.52	8.66	8.46	8.26	8.63	8.37	10.00	10.00
April	11.63	10.73	9.64	8.75	8.50	8.20	8.67	8.30	10.11	10.00
May	11.65	10.77	9.66	8.75	8.46	8.16	8.65	8.28	10.50	10.00
June	11.55	10.62	9.63	8.58	8.37	8.11	8.49	8.26	10.50	10.00
July	11.48	10.57	9.53	8.51	8.15	8.03	8.36	8.19	10.39	10.00
August	11.36	10.43	9.37	8.37	8.07	7.86	8.29	7.99	10.00	9.73
September	11.21	10.22	9.19	8.18	7.96	7.74	8.17	7.93	10.00	9.50
October	11.07	10.06	8.99	8.03	7.85	7.53	8.02	7.75	10.00	9.50
November	10.96	9.97	8.82	7.98	7.63	7.36	7.86	7.58	9.51	9.50
December	10.85	9.76	8.68	7.71	7.56	7.12	7.69	7.35	9.50	9.26

Fore. = November Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

Georgia State University

a unit of the university system of georgia

university plaza
atlanta, georgia 30303-3083

college of business administration
economic forecasting center
404 656-3282

MONTHLY PROJECTIONS December 1985

Dr. Donald Ratajczak, Director
For Release: December 20, 1985

FOURTH QUARTER IS WEAKER BUT WITH MORE MOMENTUM THAN PREVIOUSLY THOUGHT

Note: Because of the holiday season, no attempt has been made to evaluate the significance of the GNP data revisions at the present time. A detailed analysis of the economic significance derived from those revisions will be available in our January Projections. The following analysis is based upon monthly data available prior to the adjusted GNP data.

Both retail sales and industrial production suggest that economic activity was weaker in October than originally expected. Retail sales were revised downward to show a decline of 4.2% in that month while industrial production showed a recession-type decline of 0.4%. We had some difficulty relating these unusually weak statistics to the performance of other components during that month, as retail inventories surged by nearly 3%. In addition, merchandise trade deficits appeared to diminish. At the same time, shipments of capital goods from durable manufacturers jumped by an unusually large amount. In other words, less appears to have been produced and fewer net imports appear to have arrived. Nevertheless, more goods were shipped while retailers sharply increased their inventory holdings. Probably the discrepancy is caused by stronger imports arriving than implied by the trade deficits. However, the rebound in capital goods shipments, even though they were aircraft, suggests that fixed investment will rebound significantly in the fourth quarter.

Despite the data difficulties in understanding what actually occurred in October, both retail sales and industrial production suggest that activity rebounded sharply in November. Inventory data are not yet available for that month, but the evidence suggests that further inventory accumulation developed. Following the unusual surge in durable goods shipments in October, some decline is expected in November. Nevertheless, fixed investment continues to look healthy in the quarter. Indeed, capital spending should exceed the 0.8% decline anticipated in the latest plant and equipment expenditures' survey released by the Department of Commerce. Employment statistics, of course, suggest that more economic activity developed in October than November. However, survey timing indicates that employment performance was biased upward in October, causing a downward bias in employment changes for November. The two-month average probably is on-target for the quarter.

Despite the difficulty in determining how activity changed in October and November, it appears that downward revisions in October will lead to a lower rate of change in the GNP than previously anticipated. However, greater rates of improvement in November suggest that economic momentum has begun to intensify. While fourth quarter GNP has been reduced, activity in the first half of 1986 has been increased.

A second factor leading to more robust economic activity than previously anticipated is the more favorable outlook for inflation in the first half of 1986 than originally expected. Although oil prices are not falling any further than expected, they appear to be declining about four months earlier than anticipated. In effect, the price indices are approximately at the same point at the end of 1986 as they were expected to be a month ago. However, lower prices early in the year mean that the average inflation rate for the year will be less than originally projected. The GNP deflator will be rising only 3.4% in 1986 while the Consumer Price Index will show an increase of 3.5%. This moderation in inflationary pressures is especially noteworthy during the first half of the year. As a result, more real purchasing power is available to consumers while net exports are reduced as a result of more favorable pricing of oil imports than previously anticipated for the early months of the year. While such reduced oil prices do not provide any reason to anticipate more vigorous economic activity in 1987, unless, of course, oil prices fall further, they do result in more economic growth in 1986.

In addition, reduced inflationary pressures result in lower nominal interest rates than originally expected. While a discount rate cut is not anticipated, previous expectations that inventory investment will generate increasing pressures upon short-term interest rates have largely been eliminated from our outlook. It now appears that the federal funds rate will trade near 8% throughout next year. This suggests that the prime rate will trade near 9.5%. Bond dealers probably will want to increase the inventory of their bond holdings until yields on long-term government bonds fall below their borrowing cost. This provides an equilibrium target for long-term yields between 9.25 and 9.5% for 30-year government bonds. Of course, if the discount rate falls, the borrowing cost for holding bond inventories will decline. In addition, capital gains will be earned on the previous inventories. The bond market currently is anticipating that a discount rate cut will develop, but our projections strongly suggest that the Federal Reserve does not need such a change at the present time. Therefore, little further improvement is anticipated in long-term bond yields during 1986. On the other hand, the absence of any significant upward pressures upon short-term rates should prevent any significant upward move in long-term bond yields during the year.

Just as the bond market has begun to anticipate a discount rate cut that may not materialize, the stock market appears to be anticipating improving corporate profits, partially as a result of declining interest costs, can persist through 1986. However, as interest cost stabilize, profit gains will be more difficult to generate. Therefore, equity investors probably are paying an excessive premium for equity earnings at the present time. Our analysis does not yet show that equity values exceed our formulas by more than 10%, the presumed catastrophe point from which a significant stock market reaction develops. However, the overvaluation of equities is sufficiently close to that margin to eliminate prospects of significant capital gains in 1986.

Quarterly Profile of GNP

	<u>1985-3</u>	<u>1985-4</u>	<u>1986-1</u>	<u>1986-2</u>	<u>1986-3</u>	<u>1986-4</u>	<u>1986</u>
Real:	4.3	2.4	3.5	3.9	2.2	3.0	3.2
Price:	2.3	3.6	3.6	3.3	3.7	4.1	3.4
Nominal:	6.7	6.1	7.2	7.3	6.0	7.2	6.7

Monthly Statistical Highlight for December 1985

Payroll employment +273,000; index of hours worked +0.3%; household employment +252,000; civilian unemployment rate 7.0%; personal income +0.6%; savings rate 2.5%; personal consumption +0.7%; retail sales +1.0%; auto sales 10.0 million; housing starts +8.3%; housing permits -2.4%; construction expenditures -0.3%; business inventory +0.3%; orders for durable goods +0.7%; orders for nondefense capital goods -0.4%; industrial production +0.2%; CPI +0.3%; PPI +0.4%; consumption deflator +0.3%; leading indicators +0.3%; real GNP +2.1%; M1 +13.2%; M2 +7.2%.

Monthly Statistical Highlight for January 1986

Payroll employment +239,000; index of hours worked +0.3%; household employment +268,000; civilian unemployment rate 6.9%; personal income +0.6%; savings rate 2.7%; personal consumption +0.4%; retail sales +0.2%; auto sales 10.0 million; housing starts +2.1%; housing permits -0.9%; construction expenditures +5%; business inventory +0.3%; orders for durable goods +0.7%; orders for nondefense capital goods +0.9%; industrial production +0.2%; CPI +0.3%; PPI +0.2%; consumption deflator +0.3%; leading indicators +0.2%; real GNP +5.0%; M1 +3.5%; M2 +7.5%.

COMMENTARY

Employment - As expected, unusual timing in the employment surveys generated stronger economic gains than was consistent with October activity followed by weaker employment gains than was confirmed by the monthly statistics for November. Weakness in the workweek was November was concentrated in the trade and service sectors. Apparently, increased part-time personnel were being used to meet temporary needs in those sectors. The unemployment rate fell despite unusual sluggish employment growth because participation rates for females and teenagers declined. It appears that fewer teenagers and females are entering the workforce than had been previously been anticipated. Therefore, the unemployment rate should be able to fall at lower rates of economic activity than previously anticipated. In addition, the continuing tendency to overemploy and overinventory in the retail sector has not yet abated. As a result, productivity performance will remain subdued, leading to lower rates of growth in economic activity that is consistent with unchanged unemployment rates. This process of overstoring is expected to be temporary. Therefore, the adverse productivity performance associated with retail expansion should gradually diminish. However, this reduced growth in retail employment must await diminished expansion of retail square footage by developers. Such a slowing is not expected to materialize until very late in 1986.

Personal Income & Retail Activity - Hurricanes continues to impact the rental income component of personal income. This impact will continue to be reflected

until the December statistics. This results in lower income growth and in lower personal savings. Indeed, because repairs have increased, expenditures are also heightened even as imputed rental incomes are reduced. In addition to the temporary reductions in rental income, declining interest rates have significantly eroded interest income. This decline in interest income is expected to continue into the first quarter of 1986. It appears that short-term fluctuations in interest income have a smaller impact upon consumer spending than fluctuations in wage earnings. Apparently, the fluctuations in property income do not alter expected normal income unless they persist for relatively long periods of time. However, even short-term fluctuations in wage earnings probably will alter the anticipated earnings stream from wages. As a result, unusually low rates of savings are being generated because of the collapse in interest rates at the present time. These unusually low savings rates are expected to persist through 1986.

Retail activity has rebounded from a lower base than originally expected. As a result, consumption will be weaker in the fourth quarter than originally anticipated. Most of the revision was in auto sales, which now makes the dollar value of sales conform more closely with the unit sales reports. However, unusual weakness in nondurable sales during October also materialize. Sharp increases in prices for food and gasoline in November reversed the decline in nondurables in that month. In addition, the unusually late Thanksgiving caused the Department of Commerce to shift about 0.4 percentage points of department store activity from the December seasonal to the November report. It is not clear that retail sales are sufficiently strong in December to justify that seasonal shift. Fortunately, a rebound in auto sales early in December had some dealers once again added incentives to generate sufficient retail sales activity to cause Christmas sales to exceed previous year levels by 6%.

Construction - Housing starts in November were unusually weak, as weather undoubtedly distorted some activity. Weakness was especially dramatic in New England but also was significant in the midwest. Both areas suffered unusually early winter weather during the month. Weakness in the south and west, however, suggests that weather is not the only factor influencing housing activity. The sharp decline in single-family starts partially is responsive to the earlier report of October weakness in single-family sales. Sales weakness appears to be the result of dissipating pent-up demand and the tightening of down payment provisions for purchasing homes. A rebound is expected in December, but the weakness in single-family sales suggests that even moderately declining mortgage rates will not excite significant gains in housing activity during 1986.

Business Activity - Once again sharp inventory increases in October created substantial surprise in business inventories. It now appears that inventory investments will be much more substantial in the fourth quarter than they were during the summer. However, substantial completions of aircraft, which were delivered by durable manufacturers, caused a significant decline in manufacturers' inventories during October. This appears to be a one-time downward adjustment from which manufacturing inventories now will rebound. On the other hand, the surge in October shipments of aircraft will probably be followed by some weakness in shipments in the next month or so.

Industrial production increased as expected following a more than anticipated downward revision in October. All major sectors of the economy showed some improvement, but autos were only assembled at 7.7 million. Higher auto assemblies appear likely in the coming months. Thus, industrial production of

consumer goods should continue to grow through the quarter. In addition, frigid weather will cause a significant rebound in utility production in the November and December indices. With manufacturing inventories beginning to rebound, further gains are expected in materials production as well. It, therefore, appears that manufacturing will register significant employment gain in 1986.

Miscellaneous - The earlier decline in oil prices will cause the inventory valuation adjustment to improve earlier and more sharply than originally anticipated. As a result, the increase in business inventory is even more significant than suggested by the unadjusted data. These favorable inventory valuations have two significant effects upon the 1986 outlook. First, adjusted operating profits will be even more favorable than reported profits suggests as inventories will be replaced at lower prices. Coupled with declining interest costs, at least early in the year, these profit prospects nearly justify the recent rebound in stock prices. Second, falling inventory prices increased these storage costs of holding inventories. As a result, an inventory buildup will be strongly resisted by producers. While this will generate sluggish economic activity, it also will prevent a significant surge in inventory investments, which normally leads to an economic decline.

FINANCIAL MARKETS

The odds still are against a discount rate cut by the Federal Reserve. Money growth has resumed an unusually vigorous path in November and December while broader monetary aggregates did not rebound as rapidly as M1 in November, all money aggregates appear to be growing rapidly in December. In addition, the dollar's value has gradually decreased even without substantial Federal Reserve intervention. The Federal Reserve might decide to keep a discount rate cut on the sidelines in case the dollar rebounds significantly. At that time, the discount rate cut could regenerate favorable currency movements.

Also, economic activity appears to be rebounding, if only slightly. We are currently projecting 5% real growth in GNP for January. It is conceivable that the Federal Reserve also anticipates some acceleration of activity. Of course, inflation remains well subdued at least until oil prices stabilize. Furthermore, the Congress has voted its intentions to become more restrictive in budgetary policy. However, the Federal Reserve probably will wait until fiscal restraint begins to develop.

Equity Markets - If long-term interest rates continue to yield 9.5% for 30-year government securities, the recent stock market rally is nearly justified by the decline in interest rates and the projected improvement in earnings on equity ownership. Of course, a discount rate cut would lower the interest cost, leading to higher equity earnings. It probably also would cause further declines in yields in long-term bonds. Thus, current stock market values would be justified if a discount rate reduction occurred. Our analysis is not anticipating such a favorable Federal Reserve event. For that reason, it appears that modest vulnerability current exists in the equity markets. While no dramatic selloff appears to be brewing, some profit-taking certainly could be justified under current economic conditions.

EMPLOYMENT

	Payroll Employment		Index of Hours Worked		Household Civilian Employment		Civilian Unemployment Rate		Hourly Earnings Index	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1985	97707	97707	116.0	116.0	106862	106862	7.3	7.3	165.4	165.4
August	97987	97977	116.7	116.7	107172	107172	7.0	7.0	165.6	165.7
September	98115	98217	117.2	117.0	107544	107544	7.1	7.1	165.6	166.7
October	98496	98571	117.5	117.4	107853	107867	7.1	7.1	166.3	166.4
November	98823	98753	117.7	117.3	108196	107927	7.1	7.0	167.0	166.9
December	99146	99026*	118.0	117.6*	108539	108179*	7.0	7.0*	167.7	167.3*
January 1986	99301	99265	118.3	117.9	108716	108447	6.9	6.9	168.3	167.8
February	99422	99438	118.5	118.1	108893	108639	6.8	6.8	168.7	168.2
March	99545	99615	118.7	118.3	109070	108841	6.7	6.8	169.2	168.8
April	99764	99801	118.9	118.5	109283	109046	6.7	6.8	169.8	169.4
May	99981	99993	119.1	118.7	109516	109275	6.7	6.7	170.3	169.9
June	100198	100205	119.3	118.9	109782	109499	6.8	6.7	170.9	170.4
July	100306	100378	119.4	119.1	109913	109702	6.7	6.7	171.4	171.0
August	100417	100526	119.5	119.2	110029	109890	6.7	6.7	171.9	171.5
September	100529	100691	119.5	119.4	110142	110075	6.8	6.8	172.5	172.0
October	100683	100844	119.7	119.6	110316	110265	6.7	6.8	172.9	172.4
November	100840	100973	119.9	119.7	110548	110455	6.7	6.8	173.3	172.9
December	100997	101102	120.2	119.9	110780	110604	6.7	6.9	173.8	173.5

PERSONAL INCOME

	Personal Income		Wage & Salary		Personal Savings		Disposable Income		Personal Outlays	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1985	3.189	3.188	1.923	1.923	104.0	98.7	2.707	2.707	2.603	2.608
August	3.199	3.196	1.934	1.933	79.2	74.2	2.713	2.710	2.634	2.636
September	3.209	3.207	1.949	1.945	51.9	48.6	2.717	2.716	2.665	2.667
October	3.225	3.221	1.960	1.953	83.1	80.3	2.730	2.725	2.647	2.645
November	3.254	3.232*	1.972	1.959*	91.2	70.6*	2.755	2.733*	2.664	2.662*
December	3.279	3.251	1.985	1.971	92.2	68.1	2.777	2.749	2.685	2.681
January 1986	3.290	3.269	1.997	1.983	89.5	74.9	2.789	2.768	2.699	2.693
February	3.310	3.286	2.006	1.993	93.0	77.8	2.804	2.782	2.711	2.704
March	3.332	3.305	2.015	2.004	99.9	80.5	2.820	2.798	2.720	2.716
April	3.349	3.325	2.026	2.017	97.6	86.9	2.834	2.814	2.736	2.727
May	3.365	3.342	2.036	2.027	92.6	86.1	2.847	2.827	2.754	2.741
June	3.381	3.359	2.047	2.038	89.5	89.0	2.859	2.840	2.769	2.751
July	3.397	3.377	2.054	2.050	92.5	87.3	2.872	2.854	2.780	2.767
August	3.412	3.395	2.062	2.050	90.7	84.4	2.883	2.869	2.792	2.785
September	3.428	3.411	2.070	2.070	89.4	82.3	2.896	2.882	2.807	2.800
October	3.443	3.430	2.079	2.081	83.0	81.9	2.907	2.897	2.824	2.815
November	3.459	3.445	2.090	2.090	77.1	80.2	2.920	2.909	2.843	2.829
December	3.475	3.466	2.102	2.103	74.8	82.2	2.933	2.927	2.858	2.845

Fore. = November Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

CONSUMPTION

	Personal Consumption		Durables		Nondurables		Services		Consumption Real	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1985	2506.9	2511.3	336.9	336.9	892.1	892.1	1277.9	1282.2	1103.1	1104.1
August	2536.1	2538.0	357.4	357.7	893.6	895.4	1285.1	1284.9	1114.8	1116.6
September	2566.6	2567.6	372.5	375.6	901.1	903.0	1292.9	1288.9	1127.7	1128.9
October	2546.9	2544.2	338.9	335.6	906.3	911.5	1301.7	1297.1	1112.2	1111.1*
November	2562.2	2560.5*	340.5	338.2*	911.1	916.7*	1310.6	1305.6*	1114.5	1114.4
December	2581.7	2577.9	342.1	342.8	916.2	920.6	1323.4	1314.5	1118.6	1118.8
January 1986	2595.5	2588.9	342.3	342.7	920.7	923.9	1332.5	1322.3	1121.7	1120.2
February	2606.1	2598.9	343.0	339.9	923.5	928.3	1339.6	1330.7	1122.8	1120.8
March	2614.3	2611.0	342.5	340.9	924.5	931.2	1347.3	1338.9	1122.5	1123.5
April	2629.3	2619.5	344.7	340.0	927.8	932.8	1356.8	1346.7	1126.0	1122.0
May	2645.8	2632.3	346.3	339.8	933.2	937.9	1366.3	1354.6	1129.7	1127.3
June	2659.5	2641.3	344.9	340.1	938.9	937.4	1375.7	1363.8	1131.7	1127.1
July	2668.4	2655.9	344.1	341.0	939.7	942.0	1384.6	1372.9	1130.7	1129.7
August	2680.1	2672.7	344.4	342.4	940.4	946.7	1395.3	1383.6	1131.3	1132.9
September	2693.3	2686.7	345.9	344.6	941.4	950.6	1406.0	1391.5	1132.6	1135.3
October	2709.4	2701.0	346.8	347.6	947.8	952.5	1414.8	1400.9	1135.1	1137.9
November	2727.0	2713.5	348.6	347.4	954.2	955.3	1424.2	1410.8	1138.6	1139.0
December	2741.0	2728.4	350.1	349.5	957.3	959.3	1433.6	1419.6	1140.7	1141.2

RETAIL SALES

	Retail Sales		Non-Auto Durables		Auto (Million Units)		Nondurable Sales		Auto Sales	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1985	114.42	114.42	16.47	16.47	10.3	10.3	72.08	72.08	25.87	25.87
August	117.04	116.98	16.70	16.82	12.6	12.6	72.77	72.70	27.57	27.46
September	120.23	119.54	16.80	16.91	14.5	14.4	73.22	72.95	30.20	29.68
October	115.85	114.55	16.84	17.32	9.8	9.6	73.68	72.66	25.33	24.57
November	115.91	115.85	16.90	17.45	9.9	9.8	74.05	73.61	24.96	24.80
December	115.88	116.99*	16.96	17.58*	10.1	10.0*	74.14	74.16*	24.78	25.25*
January 1986	116.68	117.25	17.01	17.46	9.9	10.0	74.58	74.43	25.09	25.36
February	117.26	117.25	17.08	17.50	9.9	9.8	75.13	74.78	25.05	24.97
March	117.23	117.61	17.15	17.53	9.8	9.8	75.01	75.02	25.07	25.06
April	117.89	117.63	17.25	17.59	9.8	9.7	75.49	75.15	25.15	24.89
May	118.27	118.01	17.20	17.68	9.9	9.6	75.75	75.56	25.32	24.77
June	118.55	118.01	17.20	17.57	9.9	9.6	76.02	75.52	25.33	24.92
July	118.60	118.50	17.28	17.62	9.7	9.6	76.28	75.89	25.04	24.99
August	118.87	119.05	17.35	17.58	9.6	9.7	76.46	76.27	25.06	25.20
September	118.59	119.64	17.20	17.67	9.5	9.7	76.30	76.58	25.09	25.39
October	119.45	120.16	17.32	17.73	9.5	9.8	76.86	76.73	25.27	25.70
November	120.25	120.36	17.45	17.81	9.6	9.7	77.36	76.96	26.44	25.59
December	120.95	120.95	17.46	17.85	9.7	9.8	77.89	77.28	25.60	25.82

Fore. = November Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

CONSTRUCTION

	Housing Starts		Single Family Starts		Housing Permits		Construction Expenditures (Current)		Construction Expenditures (Real)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1985	1.663	1.663	1.062	1.062	1.694	1.694	340.2	344.8	201.7	204.4
August	1.746	1.740	1.074	1.059	1.784	1.784	344.0	344.7	204.5	204.9
September	1.583	1.616	0.962	0.975	1.796	1.808	348.0	346.1	206.7	205.8
October	1.685	1.761	1.003	1.125	1.741	1.688	348.3	347.8	206.0	206.7
November	1.723	1.547	1.058	0.928	1.683	1.648	349.0	349.5*	205.3	207.3*
December	1.734	1.675*	1.065	1.042*	1.675	1.608*	350.9	348.6	205.3	206.4
January 1986	1.708	1.711	1.025	1.063	1.638	1.593	352.2	350.2	205.5	207.0
February	1.695	1.676	1.027	1.055	1.563	1.572	354.9	351.2	206.6	207.2
March	1.691	1.720	1.053	1.103	1.558	1.578	357.6	354.9	207.8	208.9
April	1.708	1.777	1.046	1.128	1.569	1.623	359.2	356.5	207.9	209.3
May	1.713	1.755	1.057	1.114	1.583	1.637	360.5	357.9	207.9	209.7
June	1.649	1.733	1.065	1.109	1.542	1.616	362.1	359.8	208.1	210.3
July	1.628	1.654	1.053	1.072	1.497	1.562	362.9	360.4	208.0	210.1
August	1.615	1.678	1.058	1.105	1.483	1.551	363.4	359.5	207.7	209.1
September	1.603	1.701	1.046	1.117	1.480	1.575	364.0	360.4	207.4	209.0
October	1.583	1.697	1.050	1.086	1.472	1.543	362.2	360.1	205.7	208.3
November	1.587	1.693	1.051	1.076	1.483	1.527	360.4	362.3	203.8	208.8
December	1.618	1.680	1.063	1.079	1.491	1.530	360.9	363.0	203.3	208.6

	Non-Residential		Public Construction		Residential Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1985	131.0	131.1	64.7	64.5	144.5	149.2
August	132.3	132.4	64.4	64.0	147.2	148.3
September	133.5	133.7	64.8	63.4	149.7	149.0
October	135.0	132.4	65.0	64.0	148.3	151.4
November	136.6	133.5*	64.8	64.2*	147.6	151.8*
December	138.1	134.4	64.9	64.5	147.9	149.7
January 1986	139.0	134.3	63.9	64.1	149.3	151.8
February	140.1	135.5	64.0	64.4	150.8	151.3
March	141.2	136.1	64.2	64.9	152.2	153.9
April	142.2	136.5	65.0	65.2	152.0	154.8
May	143.1	136.9	66.1	65.6	151.3	155.4
June	144.0	137.4	67.3	66.0	150.8	156.4
July	144.7	138.0	67.7	66.2	150.5	156.2
August	145.3	138.3	68.1	66.5	150.0	154.7
September	145.8	138.9	68.6	66.9	149.6	154.6
October	146.0	138.8	67.9	67.3	148.3	154.0
November	146.2	139.6	66.8	67.7	147.4	155.0
December	146.2	140.0	67.2	68.0	147.5	155.0

Fore. = November Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

BUSINESS ACTIVITY

	Manufacturers' Inventories		Durable Goods Orders		Non-Defense Capital Goods Orders		Non-Defense Capital Shipments	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1985	285.0	285.0	104.37	104.37	26.69	26.69	27.04	27.04
August	284.6	284.7	107.33	107.66	27.55	27.55	27.79	27.79
September	284.9	284.0	106.11	106.64	28.85	29.24	26.54	26.72
October	285.2	282.1	105.58	104.44	28.26	27.17	27.25	27.93
November	285.9	282.7*	105.03	106.22*	28.11	27.93*	27.39	27.61*
December	286.5	283.6	105.46	106.94	28.42	27.83	27.54	27.95
January 1986	287.7	284.4	107.19	107.65	28.93	28.07	27.81	27.58
February	289.0	285.5	107.63	108.13	29.06	28.33	27.93	27.82
March	290.1	286.6	104.85	108.44	27.62	28.40	27.76	28.01
April	291.6	287.9	104.99	107.85	27.95	28.16	28.04	28.16
May	292.9	289.1	106.27	107.72	28.36	27.95	28.36	28.35
June	294.3	290.3	107.73	107.46	28.53	27.91	28.70	28.43
July	295.8	291.4	108.82	107.27	28.75	27.68	28.86	28.40
August	297.5	292.6	108.51	107.35	28.92	27.69	28.55	28.37
September	298.9	293.7	107.65	107.92	28.68	27.78	28.67	28.32
October	300.2	294.9	106.93	108.16	28.62	27.93	28.95	28.45
November	301.7	296.1	105.88	108.53	28.51	28.06	29.10	28.51
December	303.0	297.3	106.27	108.68	28.68	28.15	29.19	28.59

	Business Inventories		Defense Shipments		Industrial Production		Capacity Utilization	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1985	580.1	580.1	6.83	6.83	124.1	124.1	80.2	80.2
August	577.9	578.2	7.16	7.16	124.8	125.2	80.5	80.7
September	574.2	578.9	7.07	7.13	124.7	125.0	80.2	80.4
October	576.3	582.0	7.15	7.69	125.1	124.6	80.3	79.9
November	577.8	583.5*	7.21	7.33*	125.7	125.1	80.5	80.1
December	579.1	585.1	7.25	7.38	126.2	125.4*	80.6	80.2*
January 1986	581.6	586.7	7.36	7.43	126.7	125.7	80.8	80.3
February	584.3	588.6	7.47	7.49	127.1	125.9	80.9	80.3
March	587.1	590.5	7.60	7.60	127.8	126.2	81.1	80.4
April	590.0	592.7	7.71	7.68	128.0	126.4	81.0	80.4
May	592.8	595.0	7.75	7.76	127.8	126.6	80.7	80.3
June	595.7	597.1	7.77	7.83	127.6	126.8	80.4	80.3
July	598.4	599.4	7.89	7.91	127.4	126.8	80.1	80.1
August	601.3	601.4	8.01	8.04	127.2	126.9	79.8	80.0
September	604.4	603.7	8.10	8.12	127.2	127.1	79.6	79.9
October	607.6	606.2	8.18	8.21	127.1	127.3	79.3	79.9
November	610.5	608.7	8.27	8.33	127.1	127.3	79.1	79.7
December	613.4	611.2	8.36	8.42	127.0	127.5	78.8	79.7

Fore. = November Forecast

C.E. = Current Expectations

* = This item and those beyond it are expectations.

PRICES

	CPI-U		PPI		PPI-Industrial		Estimated GNP	
	(seasonally adjusted)		Finished Goods (seasonally adjusted)		Commodities (unadjusted)		Deflator	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1985	322.4	322.4	294.4	294.4	324.3	324.4	231.80	231.66
August	323.3	323.0	293.5	293.5	323.6	323.6	232.45	231.93
September	324.2	323.6	291.7	291.7	322.5	322.5	233.07	231.96
October	325.3	324.6	293.6	294.4	324.3	324.4	234.18	233.19
November	326.5	326.2	294.8	296.7	324.5	325.0	234.76	233.95
December	327.7	327.2*	295.6	297.5*	324.7	324.9*	235.46	234.66
January 1986	328.6	328.2	296.1	298.2	325.0	325.3	236.35	235.37
February	329.5	329.1	297.0	299.3	324.5	324.4	237.30	236.11
March	330.4	329.7	297.8	299.0	324.6	323.7	238.04	236.59
April	331.9	330.5	298.5	299.3	325.0	324.3	238.72	237.59
May	333.3	331.5	299.3	299.6	325.9	324.9	239.64	237.71
June	334.8	332.4	300.1	300.0	326.8	325.6	240.56	238.51
July	335.9	333.3	300.7	300.6	327.0	326.3	241.50	239.29
August	337.1	334.4	301.5	301.1	327.9	327.0	242.42	240.16
September	338.3	335.6	302.0	301.5	326.2	325.3	243.34	240.93
October	339.5	336.5	303.1	302.0	328.6	327.8	244.17	241.70
November	340.7	337.6	303.9	302.4	328.8	328.4	245.06	242.57
December	341.9	338.8	304.4	302.8	329.1	328.9	245.95	243.44

	Consumption		Consumer		Consumer		Consumer		Implicit	
	Deflator		Durables		Nondurables		Services		Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1985	227.3	227.5	177.8	177.8	221.7	221.7	250.0	250.4	168.7	168.7
August	227.5	227.3	178.8	178.3	221.7	221.4	251.0	251.2	168.2	168.2
September	227.6	227.4	179.1	178.3	222.0	222.1	251.9	252.0	168.3	168.2
October	229.0	229.0*	177.8	177.5*	222.9	222.8*	252.9	252.9*	169.1	168.3
November	229.9	229.8	178.0	177.9	223.9	223.9	254.0	253.6	170.0	168.6*
December	230.8	230.4	178.2	178.0	224.8	224.8	254.8	254.4	170.9	168.9
January 1986	231.4	231.1	178.4	178.3	225.2	225.1	255.9	255.5	171.4	169.2
February	232.1	231.9	178.6	178.7	225.6	225.4	257.0	256.5	171.8	169.5
March	232.9	232.4	178.9	179.0	225.8	225.3	258.1	257.6	172.1	169.9
April	233.5	233.5	179.1	179.3	226.3	225.1	259.1	258.5	172.8	170.3
May	234.2	233.5	179.3	179.6	226.8	225.4	260.2	259.5	173.4	170.7
June	235.0	234.4	179.5	180.0	227.4	226.0	261.3	260.6	174.0	171.1
July	236.0	235.1	179.8	180.4	228.0	226.4	262.7	261.7	174.5	171.5
August	236.9	235.9	180.1	180.8	228.6	226.9	264.0	262.9	175.0	171.9
September	237.8	236.7	180.4	181.2	229.2	227.4	265.3	264.0	175.5	172.4
October	238.7	237.4	180.8	181.7	229.8	227.8	266.4	265.1	176.1	172.9
November	239.5	238.2	181.2	182.3	230.4	228.3	267.5	266.2	176.8	173.5
December	240.3	239.1	181.5	182.8	231.0	228.9	268.6	267.4	177.5	174.0

Fore. = November Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

MISCELLANEOUS

	Merchandise Trade Balance		Leading Indicators		Estimated GNP		Estimated GNP (1972 \$)		IVA (annual rate)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1985	-10.51	-10.51	168.7	168.7	3885	3889	1676	1679	6.7	6.7
August	-9.90	-9.90	170.1	170.0	3921	3924	1687	1692	6.8	6.8
September	-11.50	-15.50	171.0	170.6	3942	3934	1691	1696	4.8	9.0
October	-10.68	-11.47	171.1	171.1	3967	3955	1694	1696	2.2	7.3
November	-10.92	-11.93*	171.3	171.8*	3992	3974	1700	1699	-3.5	5.6
December	-11.16	-12.96	171.9	172.3	4016	3993	1706	1702	-6.5	3.5
January 1986	-11.01	-12.16	171.6	172.6	4043	4023	1711	1709	-3.6	1.9
February	-11.96	-11.54	171.9	173.2	4067	4043	1714	1712	-0.9	3.6
March	-11.44	-11.22	172.2	173.0	4101	4070	1723	1720	0.5	6.1
April	-10.27	-11.06	171.8	171.9	4122	4095	1727	1724	1.2	9.4
May	-11.46	-10.53	171.5	172.1	4144	4118	1729	1732	2.1	9.7
June	-12.21	-10.75	172.2	171.8	4157	4138	1728	1735	1.8	9.0
July	-9.73	-11.07	171.6	171.5	4176	4154	1729	1736	0.5	7.8
August	-11.48	-10.61	170.9	171.8	4197	4177	1731	1739	-3.6	6.5
September	-11.32	-10.27	170.8	172.3	4218	4203	1733	1744	-6.5	3.7
October	-11.20	-10.11	170.3	172.5	4239	4231	1736	1751	-6.5	2.8
November	-10.96	-10.16	170.9	172.2	4262	4251	1739	1752	-7.3	2.1
December	-10.04	-9.96	171.3	172.2	4286	4273	1743	1755	-7.8	1.7

Fore. = November Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

FINANCIAL MARKETS

	Monetary Base		M1		M2		Federal Funds		T-Bills (6 Mos.)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1985	228.0	227.9	595.8	595.8	2490.5	2490.6	7.88	7.88	7.16	7.16
August	229.3	229.4	605.9	605.9	2513.7	2514.1	7.90	7.90	7.32	7.32
September	231.3	231.3	611.7	611.9	2528.4	2528.9	7.92	7.92	7.42	7.27
October	231.7	231.3	610.5	611.1	2540.5	2533.4	7.95	7.99	7.40	7.33
November	232.8	232.7	612.6	617.7	2557.1	2547.3	8.15	8.05	7.58	7.30
December	234.0	235.5*	615.3	624.1*	2573.6	2562.1*	8.29	7.98*	7.64	7.09*
January 1986	235.4	236.2	619.1	625.9	2590.4	2577.5	8.25	8.06	7.66	7.16
February	236.8	237.3	622.3	628.1	2606.8	2595.5	8.36	8.03	7.79	7.27
March	238.1	238.5	625.3	631.1	2623.2	2613.7	8.50	7.97	7.92	7.22
April	239.3	239.5	628.2	633.5	2640.4	2632.0	8.59	7.93	7.98	7.16
May	240.5	240.6	630.6	636.4	2655.2	2650.4	8.55	7.90	7.95	7.20
June	241.7	241.4	633.0	638.0	2667.3	2663.7	8.42	7.92	7.86	7.27
July	243.0	242.8	635.0	641.5	2682.5	2682.3	8.26	7.82	7.74	7.09
August	244.3	243.8	637.9	643.6	2700.3	2698.4	8.12	7.73	7.63	7.01
September	245.6	245.1	640.8	646.3	2719.6	2714.6	8.01	7.66	7.46	6.88
October	247.0	246.5	644.4	649.5	2738.5	2733.6	7.86	7.59	7.45	6.83
November	248.3	247.7	648.3	652.7	2755.0	2752.7	7.71	7.73	7.43	6.95
December	249.6	248.8	650.7	655.1	2772.1	2769.2	7.59	7.60	7.41	6.92

	Aaa (Seasoned)		Municipals (Bond Buyer)		(3 Month) Commercial Paper		90 Day CD's		Prime Rate	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
July 1985	10.97	10.97	8.81	8.81	7.56	7.56	7.74	7.74	9.50	9.50
August	11.05	11.05	9.13	9.08	7.72	7.72	7.81	7.81	9.50	9.50
September	11.07	11.07	9.32	9.32	7.83	7.83	7.93	7.93	9.50	9.50
October	11.08	11.02	9.25	9.08	7.82	7.80	7.90	7.88	9.50	9.50
November	11.20	10.55	9.30	8.54	8.16	7.77	8.26	7.81	9.50	9.50
December	11.38	10.21*	9.36	8.46*	8.30	7.85*	8.42	7.94*	9.50	9.50*
January 1986	11.40	9.96	9.39	8.07	8.14	7.96	8.27	8.05	9.88	9.50
February	11.46	9.83	9.46	7.96	8.35	8.02	8.49	8.16	10.00	9.50
March	11.51	9.95	9.52	8.08	8.46	7.95	8.63	8.07	10.00	9.50
April	11.63	10.07	9.64	8.22	8.50	7.92	8.67	8.03	10.11	9.50
May	11.65	10.13	9.66	8.26	8.46	7.83	8.65	7.98	10.50	9.50
June	11.55	10.06	9.63	8.16	8.37	7.88	8.49	7.99	10.50	9.50
July	11.48	9.87	9.53	7.95	8.15	7.85	8.36	7.96	10.39	9.50
August	11.36	9.72	9.37	7.78	8.07	7.78	8.29	7.89	10.00	9.50
September	11.21	9.75	9.19	7.86	7.96	7.67	8.17	7.82	10.00	9.50
October	11.07	9.68	8.99	7.84	7.85	7.61	8.02	7.78	10.00	9.50
November	10.96	9.84	8.82	7.99	7.63	7.79	7.86	7.93	9.51	9.50
December	10.85	9.81	8.68	8.00	7.56	7.65	7.69	7.84	9.50	9.50

Fore. = November Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

Georgia State University

a unit of the university system of georgia

2/5/86 U1880-3
university plaza
atlanta, georgia 30303-3083

MONTHLY PROJECTIONS January 1986

Dr. Donald Ratajczak, Director
For Release: January 29, 1986

ACTIVITIES STRENGTHENING NOTICEABLY AS 1986 BEGINS

Data revisions show that economic activity was more and less than what had been expected. Initially, hopes had been raised that adjustments for appropriate price deflation of computer components and a more significant measure of untaxed income would lead to greater growth in economic activity during the past decade. In fact, inflation proved to be slightly stronger while real growth was slightly less, about 0.2 percentage points per year, than originally projected. The level of GNP was revised upward, suggesting that American workers were more productive than originally expected and also indicating that the velocity of money was higher than previously thought. However, reduced growth in economic activity in recent years provides less than beneficial interpretations for those important efficiency measures.

Sharp upward revisions in proprietors' income led to higher estimates of savings than initially reported. However, the erosion of savings in recent years remained intact, even if the savings rate late in 1985 was above 4% rather than at 3%, as originally reported. However, a significant downward revision in rental income reduces the implications of this diminished savings. Higher costs of operating housing than originally projected, lowered the rental income component by more than \$50 billion. As the downward adjustment was the result of increased cost, imputations were not affected to any measurable extent on the expenditures side of the ledger. Thus, significant imputed savings accruing from homeownership gains has been eliminated by the data revisions. There is significant dispute as to whether imputed rental income should be included in income flows. Savings from income excluding the rental component has been more stable than the dramatic decline in savings shown with the addition of rental income.

On the expenditures side, the most noteworthy adjustments were for housing stock and investment in structures. Instead of expanding approximately 2.6% per year in recent years, upward revisions in remodeling and modernization expenditures for housing suggest that housing stock has been expanding about 3.3%. This remodeling factor goes a long way toward explaining why housing sales have been less responsive to declining interest rates than in previous cycles. At 3.3%, additions to housing capital already appear to be adequate to meet household needs. This revision should lower estimated housing starts for any given interest rate profile in 1986 and 1987.

The accumulation of structures also appears to be more rapid than originally projected, with net capital expanding nearly 3.5% per year. This clearly demonstrates excessive accumulation of structure. On the other hand, capital accumulation for producers' durables appears to be less robust than originally projected. In effect, the capital stock has become more heavily concentrated in structures and less heavily concentrated in equipment than originally estimated. These composition shifts have been more dramatic in recent years.

Improved revenue estimates at the state and local level suggests that surpluses there have been larger than originally projected. This permits state and local governments to increase expenditures despite the loss of general revenue sharing in the next two years.

In recent quarters the revised GNP accounts use more appropriate estimates of import delivery than contained in the merchandise trade report. That report measures processed exports and imports, but processing delays have been extensive for imports. The result of this revision has been to shift economic strength between quarters in recent years. For example, the fourth quarter of 1984 now appears to have grown only 0.6% as compared to an initial 4.3%. On the other hand, the 0.3% growth initially recorded for the first quarter of 1985 is converted to a 3.7% gain. These figures are much more consistent with changes in industrial activity and increase the efficiency of our monthly model.

As mentioned in our previous projections, economic activity was even weaker in October than originally projected. Downward revisions in consumption and industrial production suggest that GNP after inflation actually declined in that month. This is the major reason why fourth quarter GNP was revised downward from the initial "flash" estimate. Of course, the "flash" also understated the magnitude of inflationary pressures developing in the fourth quarter. It is noteworthy that the acceleration of energy prices in that quarter caused the inventory valuation adjustment to shift from undervaluing inventories by \$5.1 billion to overvaluing them by \$10.1 billion. Virtually all of this adjustment was in energy materials inventories. With energy prices again falling sharply, inventories will again understate the volume of available goods. Of course, this shift in the IVA will cause higher taxable corporate profits in the fourth quarter than originally estimated. This also will lead to a higher effective tax on capital, especially in the energy-producing sectors. However, these profit conditions will reverse early in 1986.

Although the quarter started very weak, it ended very strong. Our estimates show that December activity is nearly 4% at annual rates above the fourth quarter average if GNP remains unchanged from December levels through the first quarter. Some special factors apparently enhanced the strength of economic activity in December. Renewed automobile rebates as an alternative to production curtailments explains some of the continued strength. In addition, strong shipments and orders for commercial aircraft aided capital goods in December. Some of that strength will be reversed in the early months of 1986. Also, some of the strong shipments of capital goods reflect deliveries of the IBM Sierra system. These deliveries will continue to grow rapidly through the first quarter of 1986 and then slow thereafter.

However, strength also appeared in industrial materials, suggesting that inventories once again are being accumulated at the manufacturing and wholesale level following nearly a year of liquidations. These inventory gains will continue to generate relatively vigorous increases in industrial production for a

few more months. A last area of surprising strength was in housing. Building permits leaped above 1.8 million units in December, a level that could support almost two million starts. It is clear that construction activity will continue to grow strongly in the early months of 1986, although a reduction in nonresidential construction orders in November may be the beginning of an orders correction that will ultimately lead to expenditures reductions during the second half of the year. At any rate, economic activity is surprisingly robust as 1986 begins. The consensus forecast that the economy will struggle through the early months of 1986 before improvement in net exports create greater growth later in the year probably should be reversed. Activity appears to be very strong early in 1986, but the fade-off in capital shipments and projected reductions in construction later should sharply slow the growth of economic activity by year-end.

Normally, such intensifying gains in economic activity would lead to increasing interest rates. Indeed, our earlier projections showed rising rates in the spring followed by further weakness later in the year. However, sharply falling oil prices will cause the GNP deflator and especially the CPI and PPI measures of inflation to slow sharply early in 1986. Thus, real growth will be supported by reduced inflation. This type of economic environment will put only moderate pressures upon the credit markets. As the Federal Reserve may be encouraged to add stimulus to the economy after the latest bout of auto incentives is over and economic activity slows in the spring, declining interest rates now appear to be likely in the spring. However, the downward movement in rates should not be dramatic.

Stronger real growth but lower inflation probably will add to corporate profitability, although there will be relatively little improvement in profit margins. Most of the improved profitability will be generated by increased productivity performance deriving from stronger real growth. However, continued moderate increases in wage demands, if the December surge can be discounted, and no significant increase in interest expenses, suggest that corporate profits will be growing somewhat faster than nominal GNP during 1986. Our current projections are for profit gains after adjustment for IVA and capital consumption adjustment of approximately 11%. Because interest rates are expected to fall slightly, these changes could justify stock market values as measured on the Dow Jones averages approaching 1700 in the summer months. Declining stock values then may materialize if rising wage costs and interest rate pressures surface toward the end of the year.

Quarterly Profile of GNP

	<u>1985-3</u>	<u>1985-4</u>	<u>1986-1</u>	<u>1986-2</u>	<u>1986-3</u>	<u>1986-4</u>	<u>1986</u>
Real:	3.0	2.4	4.7	2.6	3.7	3.3	3.2
Price:	2.9	3.3	2.3	3.6	3.2	3.9	3.0
Nominal:	5.8	5.9	7.0	6.1	7.1	7.2	6.4

Monthly Statistical Highlights for January 1986

Payroll employment +215,000; index of hours worked, UNC; household employment +233,000; civilian unemployment rate 6.9%; personal income -0.1%; savings rate 3.1%; personal consumption +0.5%; retail sales +0.8%; auto sales 11.9 million; housing starts -1.3%; housing permits -5.9%; construction expenditures +1.2%; business inventories +0.1%; orders for durable goods -1.8%; orders for nondefense capital goods -13.8%; industrial production +0.4%; CPI +0.1%; PPI -0.2%; consumption deflator +0.1%; leading indicators -0.3%; real GNP +2.7%; M1 +6.3%; M2 +10.4%.

Monthly Statistical Highlights for February 1986

Payroll employment +223,000; index of hours worked +0.2%; household employment +260,000; civilian unemployment rate 6.8%; personal income +0.6%; savings rate 3.8%; personal consumption -0.0%; retail sales -1.0%; auto sales 10.5 million; housing starts +3.4%; housing permits +0.4%; construction expenditures +0.7%; business inventories +0.3%; orders for durable goods +1.6%; orders for nondefense capital goods +5.4%; industrial production +0.3%; CPI +0.2%; PPI -0.1%; consumption deflator +0.3%; leading indicators -0.2%; real GNP +1.7%; M1 +7.3%; M2 +8.7%.

COMMENTARY

Employment - December's employment report was surprisingly robust, with payroll employment increasing 320,000 and the manufacturing workweek growing by 0.3 hours. The index of hours worked increased 4.1% at annual rates during the fourth quarter. Obviously, the estimated 2.4% increase in economic activity suggests that productivity declined significantly. Nevertheless, the weakness in productivity is inconsistent with improving industrial activity and extensions of overtime hours. This strongly suggests that fourth quarter GNP estimates may be revised upward. Employment strength was widespread. In addition, wages per hour grew sharply. However, the quarterly increase in the hourly earnings index is only 3.8%, and the index is only 3.1% above previous year levels. Therefore, the 0.8% movement in that index during December must be viewed as an aberration which ought to be followed by much more subdued changes in hourly earnings. It also is likely that the workweek was extended because improving orders in December were not expected to be sustained. If those orders remain reasonably robust early in 1986, as anticipated, the workweek will shorten while payrolls continue to grow rapidly. Despite the obvious reduction in productivity during the fourth quarter, productivity should increase measurably in 1986. In addition, the workweek probably will diminish following unusually rapid increases in recent months.

Personal Income & Retail Activity - Several extraordinary items helped to swell personal income in December. First, significant support from the Commodity Credit Corporation led to more than \$13 billion gains in December's farm income. As few crops will be available to be placed on farm programs early in 1986, farm incomes will fall back to the \$20 billion range. Second, the absence of hurricane and flood dislocations on rental income led to more than a \$4 billion surge in that component. Minimal changes will develop in January. Third, pay increases for the military raised government salaries both in November and December. While those increases will not be reversed, there will be little

contribution from additional pay increases in January. In addition to the absence of these favorable conditions, January's personal income will be slowed by much more moderate gains in wage and salaries than in December and by increased Social Security taxes, which will take about \$4 billion from the January estimates. When all these factors are combined, personal income should decline slightly in January.

Although data revisions significantly increased the level of personal income as a result of the changes in proprietors' income, rental income, and military salaries, they have not significantly altered our projections of growth in the next year. In effect, slower growth in farm income than previously projected will be offset by more rapid gains in wage and salary income.

A surge in spending for services in December substantially contributed to the expansion in personal consumption. Of course, financial incentives to purchase automobiles also raised expenditures for durables. These incentives are expected to continue generating sharply higher auto sales through January, but the impact will wear out even before the incentives are scheduled to be removed in the latter part of February. Another bout of incentives is expected to clear excess inventories late in the summer before the 1987 models are introduced. Declining oil prices will dramatically slow the growth of expenditures for nondurable goods early in the year. As oil prices diminish their deflationary impact late in the spring, more normal growth is expected. Declining oil prices also will impact utility costs in the services component.

Construction - Housing starts and housing permits rebounded sharply in December following an apparently weather-induced decline in November. Much of the gain in permits was in rental properties. Apparently, builders believe that tax reform may come but will not affect properties placed on the books in 1986. Therefore, a surge of permits followed by sharply increasing activity now appears to be likely early in the year. As tax reform probabilities approach late in 1986, however, housing activity should trail off sharply.

Because of the more favorable budget positions for state and local governments, public construction was revised upward slightly in our projections for later in 1986. On the other hand, a sharp drop in orders for nonresidential construction suggests that that sector will be growing slowly in the fall. As a result, construction will no longer contribute significantly to economic gains beyond the spring.

Business Activity - Durable goods orders were surprisingly strong in December as a result of a surge in orders for commercial aircraft. Defense orders continued to trail defense shipments by more than \$1 billion. A rebound in the defense component will diminish the degree of downward adjustment in orders for durable goods in January. Accelerated shipments for nondefense capital goods partially reflects deliveries of aircraft. However, some of this heightened activity is expected to persist through 1986.

As a result of stronger gains in automobiles and capital goods than originally projected, industrial production now is expected to grow slightly more rapidly in 1986 than in 1985. This will lead to slightly higher capacity utilization through the year than originally projected.

Manufacturing inventories are expected to rebound slightly in December and show more substantial gains in 1986. However, diminished auto inventories as financial incentives reduce the available auto stock will initially hold down business inventories. Later in the spring, however, inventories are expected to grow for retailers and wholesalers along with manufacturers.

Prices - Oil prices certainly have fallen earlier than originally projected. It now appears that they will also fall further than expected, with contract prices for oil probably dipping to \$22 per barrel by the end of spring. This will lead to substantially lower changes in the CPI and in PPI finished goods than originally projected. The result also will be slower growth in the consumption deflator and in the GNP deflator than earlier projected. Because of a rebasing of the GNP figures to 1982, comparisons between the forecast and current expectation are not terribly meaningful. However, the forecasted values continue to be produced in order to show what previous rates of change were anticipated in that outlook.

Miscellaneous - Sharp increases in stock prices, the workweek, orders for plants and equipment, and building permits will lead to a dramatic increase in leading indicators during December. Some of these components are not expected to contribute further to gains in January. As a result, the leading indicators probably will decline over the next two months. No substantial trend is expected for the leading indicators through 1986, possibly leading to significantly greater weakness in 1987.

A sharp reversal in the IVA appears to be the result of changes in prices for energy materials. As these price increases are rapidly reversing, the IVA is expected to again turn positive early in 1986 and stay positive through much of the year.

The merchandise trade balance continues to be reported in terms of the monthly processing of net exports. However, the report now contains, with a one-month lag, the delivery of exports and imports. These deliveries are more relevant to monthly changes in trade accounts and will be reported in place of the processed merchandise figure when more data is available.

FINANCIAL MARKETS

Although economic activity appears to be increasing significantly, much of this increase is not generating increased pressures in short-term credit markets. The reason for this dichotomy is the sharp slowing in price pressures resulting from plunging oil prices. In fact, loan pressures may be sufficiently subdued to permit the Federal Reserve to gradually lower its federal funds target. No discount rate move is anticipated, at least until this spring. However, a gradual weakening in rates for commercial paper and reduced bank aggressiveness to acquire CDs could lead to a decline in the prime rate by March. Such a lowering of short-term interest rates would permit a more substantial reduction in long-term rates than has already developed. The long-term government bond probably will yield less than 9% by June. Significant supplies of corporate financing will prevent a normal gap in yield between government issues and the Corporate AAA from developing in 1986. However, tax-exempt bonds probably will trade below 8% throughout the year.

Of course, the Federal Reserve may lower the discount rate. However, significant slowing in economic activity and a rebound in the value of the dollar probably will need to be in place before such action is taken. The slowing will develop after auto incentives are removed late in February. At the present time, however, the dollar remains under downward pressures against most major currencies.

Equity Markets

Assuming that long-term interest rates will fall to 9% for 30-year government securities, the stock market can continue to move upward in the early months of 1986. Indeed, operating profits less tax liabilities probably will increase about 11% during the year. This could justify a Dow Jones average in the vicinity of 1700 by mid-year. Late in the year, however, no further decrease in interest rates is anticipated. At the same time, economic growth is expected to gradually slow. Thus, the stock market probably will be trending downward toward the end of 1986.

EMPLOYMENT

	Payroll Employment		Index of Hours Worked		Household Civilian Employment		Civilian Unemployment Rate		Hourly Earnings Index	
	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.
July 1985	97707	97707	116.0	116.0	106862	106871	7.3	7.3	165.4	165.4
August	97987	97977	116.7	116.7	107172	107210	7.0	7.1	165.6	165.7
September	98115	98217	117.2	117.0	107544	107519	7.1	7.1	165.6	166.7
October	98496	98559	117.5	117.4	107853	107813	7.1	7.1	166.3	166.4
November	98823	98739	117.7	117.5	108196	107969	7.1	7.0	167.0	167.1
December	99146	99059	118.0	118.3	108539	108206	7.0	6.9	167.7	168.4
January 1986	99301	99274*	118.3	118.3*	108716	108439*	6.9	6.9*	168.3	168.7*
February	99422	99497	118.5	118.6	108893	108699	6.8	6.8	168.7	169.1
March	99545	99748	118.7	118.9	109070	108977	6.7	6.8	169.2	169.5
April	99764	100001	118.9	119.1	109283	109270	6.7	6.7	169.8	170.0
May	99981	100252	119.1	119.3	109516	109568	6.7	6.6	170.3	170.6
June	100198	100378	119.3	119.4	109782	109706	6.8	6.7	170.9	171.2
July	100306	100488	119.4	119.5	109913	109856	6.7	6.7	171.4	171.8
August	100417	100589	119.5	119.6	110029	109987	6.7	6.8	171.9	172.3
September	100529	100757	119.5	119.8	110142	110208	6.8	6.8	172.5	172.9
October	100683	100925	119.7	120.0	110316	110431	6.7	6.8	172.9	173.4
November	100840	101119	119.9	120.2	110548	110607	6.7	6.8	173.3	173.8
December	100997	101220	120.2	120.3	110780	110765	6.7	6.8	173.8	174.5

PERSONAL INCOME

	Personal Income		Wage & Salary		Personal Savings		Disposable Income		Personal Outlays	
	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.
July 1985	3.189	3.288	1.923	1.959	104.0	125.3	2.707	2.795	2.603	2.670
August	3.199	3.296	1.934	1.969	79.2	100.1	2.713	2.798	2.634	2.697
September	3.209	3.310	1.949	1.981	51.9	77.4	2.717	2.807	2.665	2.730
October	3.225	3.331	1.960	1.991	83.1	127.8	2.730	2.825	2.647	2.698
November	3.254	3.347	1.972	2.003	91.2	120.3	2.755	2.838	2.664	2.717
December	3.279	3.394	1.985	2.025	92.2	106.1	2.777	2.879	2.685	2.773
January 1986	3.290	3.390*	1.997	2.030*	89.5	90.1*	2.789	2.878*	2.699	2.788*
February	3.310	3.409	2.006	2.042	93.0	110.7	2.804	2.899	2.711	2.788
March	3.332	3.427	2.015	2.053	99.9	125.7	2.820	2.914	2.720	2.788
April	3.349	3.445	2.026	2.065	97.6	126.2	2.834	2.929	2.736	2.803
May	3.365	3.462	2.036	2.077	92.6	124.2	2.847	2.942	2.754	2.818
June	3.381	3.479	2.047	2.088	89.5	118.7	2.859	2.954	2.769	2.835
July	3.397	3.496	2.054	2.098	92.5	115.7	2.872	2.967	2.780	2.851
August	3.412	3.514	2.062	2.108	90.7	104.3	2.883	2.979	2.792	2.875
September	3.428	3.534	2.070	2.120	89.4	98.8	2.896	2.994	2.807	2.895
October	3.443	3.553	2.079	2.132	83.0	107.8	2.907	3.008	2.824	2.900
November	3.459	3.572	2.090	2.142	77.1	104.1	2.920	3.023	2.843	2.919
December	3.475	3.591	2.102	2.154	74.8	101.6	2.933	3.038	2.858	2.936

Fore. = November Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections

CONSUMPTION

	Personal Consumption		Durables		Nondurables		Services		Consumption Real	
	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.
July 1985	2506.9	2579.5	336.9	357.5	892.1	909.8	1277.9	1312.2	1103.1	2303.1
August	2536.1	2606.2	357.4	378.3	893.6	912.9	1285.1	1315.0	1114.8	2330.3
September	2566.6	2636.6	372.5	394.3	901.1	921.6	1292.9	1320.7	1127.7	2351.9
October	2546.9	2603.1	338.9	348.2	906.3	926.0	1301.7	1328.9	1112.2	2312.8*
November	2562.2	2621.6	340.5	353.9	911.1	926.5	1310.6	1341.3	1114.5	2317.3
December	2581.7	2675.1	342.1	375.7	916.2	935.7	1323.4	1363.7	1118.6	2358.7*
January 1986	2595.5	2689.0*	342.3	381.6*	920.7	939.6*	1332.5	1367.8*	1121.7	2368.7
February	2606.1	2688.0	343.0	371.5	923.5	939.9	1339.6	1376.6	1122.8	2362.7
March	2614.3	2686.6	342.5	362.5	924.5	939.0	1347.3	1385.1	1122.5	2354.4
April	2629.3	2699.7	344.7	361.6	927.8	943.8	1356.8	1394.3	1126.0	2359.5
May	2645.8	2713.3	346.3	363.6	933.2	946.7	1366.3	1403.0	1129.7	2364.7
June	2659.5	2729.3	344.9	366.7	938.9	950.4	1375.7	1412.2	1131.7	2371.6
July	2668.4	2743.9	344.1	369.0	939.7	953.2	1384.6	1421.7	1130.7	2377.6
August	2680.1	2765.8	344.4	378.2	940.4	956.3	1395.3	1431.3	1131.3	2389.6
September	2693.3	2784.9	345.9	383.6	941.4	960.8	1406.0	1440.5	1132.6	2398.4
October	2709.4	2788.4	346.8	373.1	947.8	965.7	1414.8	1449.6	1135.1	2393.5
November	2727.0	2805.6	348.6	377.7	954.2	969.1	1424.2	1458.8	1138.6	2399.5
December	2741.0	2821.5	350.1	379.7	957.3	972.4	1433.6	1469.4	1140.7	2403.7

RETAIL SALES

	Retail Sales		Non-Auto Durables		Auto (Million Units)		Nondurable Sales		Auto Sales	
	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.
July 1985	114.42	114.42	16.47	16.47	10.3	10.3	72.08	72.08	25.87	25.87
August	117.04	116.98	16.70	16.82	12.6	12.6	72.77	72.70	27.57	27.46
September	120.23	119.54	16.80	16.91	14.5	14.4	73.22	72.95	30.20	29.68
October	115.85	114.86	16.84	17.37	9.8	9.6	73.68	72.94	25.33	24.55
November	115.91	115.62	16.90	17.39	9.9	9.8	74.05	73.40	24.96	24.83
December	115.88	117.86	16.96	17.79	10.1	11.5	74.14	73.83	24.78	26.24
January 1986	116.68	118.86*	17.01	17.87*	9.9	11.9*	74.58	74.14*	25.09	26.85*
February	117.26	117.70	17.08	17.85	9.9	10.5	75.13	74.16	25.05	25.69
March	117.23	116.57	17.15	18.02	9.8	9.4	75.01	74.09	25.07	24.46
April	117.89	116.85	17.25	18.07	9.8	9.3	75.49	74.47	25.15	24.31
May	118.27	117.39	17.20	18.11	9.9	9.4	75.75	74.78	25.32	24.50
June	118.55	117.96	17.20	18.06	9.9	9.6	76.02	74.99	25.33	24.91
July	118.60	118.62	17.28	18.17	9.7	9.7	76.28	75.37	25.04	25.08
August	118.87	119.93	17.35	18.23	9.6	10.3	76.46	75.61	25.06	26.09
September	118.59	120.93	17.20	18.32	9.5	10.7	76.30	75.97	25.09	26.64
October	119.45	120.16	17.32	18.46	9.5	9.5	76.86	76.43	25.27	25.27
November	120.25	121.04	17.45	18.53	9.6	9.8	77.36	76.78	26.44	25.73
December	120.95	121.54	17.46	18.64	9.7	9.8	77.89	77.04	25.60	25.86

Fore. = November Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections

CONSTRUCTION

	Housing Starts		Single Family Starts		Housing Permits		Construction Expenditures (Current)		Construction Expenditures (Real)	
	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.
July 1985	1.663	1.663	1.062	1.062	1.694	1.694	340.2	344.2	201.7	203.5
August	1.746	1.740	1.074	1.059	1.784	1.784	344.0	343.2	204.5	203.3
September	1.583	1.616	0.962	0.975	1.796	1.808	348.0	346.1	206.7	204.9
October	1.685	1.772	1.003	1.120	1.741	1.688	348.3	346.3	206.0	204.8
November	1.723	1.566	1.058	0.961	1.683	1.661	349.0	348.1	205.3	206.2
December	1.734	1.840	1.065	1.113	1.675	1.844	350.9	349.4*	205.3	207.1*
January 1986	1.708	1.816*	1.025	1.121*	1.638	1.735*	352.2	353.5	205.5	209.2
February	1.695	1.878	1.027	1.153	1.563	1.742	354.9	355.8	206.6	210.2
March	1.691	1.867	1.053	1.124	1.558	1.769	357.6	359.7	207.8	212.1
April	1.708	1.825	1.046	1.105	1.569	1.726	359.2	360.6	207.9	212.1
May	1.713	1.805	1.057	1.121	1.583	1.683	360.5	362.1	207.9	212.5
June	1.649	1.762	1.065	1.093	1.542	1.641	362.1	362.1	208.1	211.9
July	1.628	1.719	1.053	1.076	1.497	1.568	362.9	361.8	208.0	211.2
August	1.615	1.717	1.058	1.085	1.483	1.579	363.4	360.7	207.7	210.2
September	1.603	1.705	1.046	1.091	1.480	1.543	364.0	360.3	207.4	209.5
October	1.583	1.708	1.050	1.106	1.472	1.552	362.2	360.4	205.7	209.1
November	1.587	1.694	1.051	1.102	1.483	1.508	360.4	360.5	203.8	208.5
December	1.618	1.674	1.063	1.091	1.491	1.509	360.9	360.5	203.3	207.9

	Non-Residential		Public Construction		Residential Construction	
	Fore	C.E.	Fore	C.E.	Fore	C.E.
July 1985	131.0	130.8	64.7	64.7	144.5	148.7
August	132.3	132.5	64.4	63.9	147.2	146.9
September	133.5	133.6	64.8	63.6	149.7	148.9
October	135.0	132.1	65.0	63.6	148.3	150.6
November	136.6	133.4	64.8	64.5	147.6	150.3
December	138.1	134.3*	64.9	65.1*	147.9	150.0*
January 1986	139.0	134.6	63.9	65.3	149.3	153.6
February	140.1	135.3	64.0	65.8	150.8	154.7
March	141.2	135.9	64.2	66.1	152.2	157.7
April	142.2	136.3	65.0	66.4	152.0	157.9
May	143.1	136.8	66.1	66.8	151.3	158.5
June	144.0	137.2	67.3	67.1	150.8	157.8
July	144.7	137.5	67.7	67.3	150.5	157.0
August	145.3	138.0	68.1	67.6	150.0	155.1
September	145.8	138.5	68.6	68.0	149.6	153.8
October	146.0	138.9	67.9	68.2	148.3	153.3
November	146.2	138.6	66.8	68.5	147.4	153.4
December	146.2	138.5	67.2	68.8	147.5	153.2

Fore. = November Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections

BUSINESS ACTIVITY

	Manufacturers' Inventories		Durable Goods Orders		Non-Defense Capital Goods Orders		Non-Defense Capital Shipments	
	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.
July 1985	285.0	285.0	104.37	104.37	26.69	26.69	27.04	27.04
August	284.6	284.7	107.33	107.66	27.55	27.55	27.79	27.79
September	284.9	284.0	106.11	106.64	28.85	29.24	26.54	26.72
October	285.2	282.4	105.58	104.50	28.26	27.09	27.25	27.72
November	285.9	281.8	105.03	103.78	28.11	25.79	27.39	27.77
December	286.5	282.4*	105.46	108.16	28.42	31.36	27.54	29.53
January 1986	287.7	283.5	107.19	106.25*	28.93	27.03*	27.81	29.03*
February	289.0	284.9	107.63	107.93	29.06	28.49	27.93	28.76
March	290.1	286.1	104.85	108.46	27.62	28.65	27.76	28.91
April	291.6	286.9	104.99	109.16	27.95	29.07	28.04	29.07
May	292.9	288.1	106.27	109.53	28.36	29.31	28.36	29.31
June	294.3	288.9	107.73	109.02	28.53	29.15	28.70	29.43
July	295.8	290.1	108.82	108.27	28.75	29.28	28.86	29.54
August	297.5	291.2	108.51	108.53	28.92	29.36	28.55	29.61
September	298.9	292.1	107.65	108.89	28.68	29.51	28.67	29.82
October	300.2	293.3	106.93	109.16	28.62	29.72	28.95	29.93
November	301.7	294.5	105.88	108.92	28.51	29.56	29.10	30.05
December	303.0	295.6	106.27	108.53	28.68	29.42	29.19	29.94

	Business Inventories		Defense Shipments		Industrial Production		Capacity Utilization	
	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.
July 1985	580.1	580.1	6.83	6.83	124.1	124.1	80.2	80.2
August	577.9	578.2	7.16	7.16	124.8	125.2	80.5	80.7
September	574.2	578.9	7.07	7.13	124.7	125.1	80.2	80.5
October	576.3	582.2	7.15	7.67	125.1	124.4	80.3	79.8
November	577.8	583.4	7.21	7.86	125.7	125.1	80.5	80.1
December	579.1	584.6*	7.25	7.87	126.2	126.0	80.6	80.5
January 1986	581.6	584.9	7.36	7.91*	126.7	126.5*	80.8	80.7*
February	584.3	586.6	7.47	7.96	127.1	126.9	80.9	80.8
March	587.1	588.9	7.60	8.03	127.8	127.2	81.1	80.8
April	590.0	591.4	7.71	8.21	128.0	127.3	81.0	80.7
May	592.8	594.2	7.75	8.24	127.8	127.5	80.7	80.6
June	595.7	596.4	7.77	8.35	127.6	127.7	80.4	80.6
July	598.4	598.8	7.89	8.39	127.4	127.9	80.1	80.5
August	601.3	600.5	8.01	8.43	127.2	128.4	79.8	80.7
September	604.4	602.3	8.10	8.41	127.2	128.3	79.6	80.4
October	607.6	605.2	8.18	8.45	127.1	128.4	79.3	80.2
November	610.5	608.2	8.27	8.49	127.1	128.5	79.1	80.1
December	613.4	611.8	8.36	8.57	127.0	128.8	78.8	80.1

Fore. = November Forecast

C.E. = Current Expectations

* = This item and those beyond it are expectations.

PRICES

	CPI-U		PPI		PPI-Industrial		Estimated GNP	
	(seasonally adjusted)		Finished Goods (seasonally adjusted)		Commodities (unadjusted)		Deflator	
	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.
July 1985	322.4	322.4	294.4	294.4	324.3	324.4	231.80	112.1
August	323.3	323.0	293.5	293.5	323.6	323.7	232.45	112.0
September	324.2	323.6	291.7	291.7	322.5	322.5	233.07	112.2
October	325.3	324.6	293.6	294.4	324.3	324.4	234.18	112.7
November	326.5	326.2	294.8	296.7	324.5	325.0	234.76	113.0
December	327.7	327.8	295.6	297.9	324.7	325.2	235.46	113.2
January 1986	328.6	328.1*	296.1	297.3*	325.0	323.9*	236.35	113.3
February	329.5	328.8	297.0	296.9	324.5	322.5	237.30	113.6
March	330.4	329.6	297.8	296.6	324.6	321.2	238.04	114.0
April	331.9	330.4	298.5	296.9	325.0	321.5	238.72	114.3
May	333.3	331.1	299.3	297.1	325.9	321.9	239.64	114.6
June	334.8	332.3	300.1	297.8	326.8	322.7	240.56	114.9
July	335.9	333.4	300.7	298.4	327.0	323.3	241.50	115.2
August	337.1	334.3	301.5	298.9	327.9	323.9	242.42	115.5
September	338.3	335.5	302.0	299.4	326.2	321.8	243.34	115.8
October	339.5	336.7	303.1	299.9	328.6	324.3	244.17	116.2
November	340.7	337.7	303.9	300.5	328.8	325.0	245.06	116.6
December	341.9	338.6	304.4	301.2	329.1	325.9	245.95	117.0

	Consumption		Consumer		Consumer		Consumer		Implicit	
	Deflator		Durables		Nondurables		Services		Construction	
	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.
July 1985	227.3	112.0	177.8	104.5	221.7	107.6	250.0	117.0	168.7	169.1
August	227.5	111.8	178.8	104.8	221.7	107.5	251.0	117.4	168.2	168.8
September	227.6	112.1	179.1	104.6	222.0	107.8	251.9	117.9	168.3	168.9
October	229.0	112.6	177.8	103.9	222.9	108.3	252.9	118.4	169.1	169.0
November	229.9	113.1	178.0	104.2	223.9	109.1	254.0	118.8	170.0	168.8
December	230.8	113.4*	178.2	104.1*	224.8	109.6*	254.8	119.2*	170.9	168.7*
January 1986	231.4	113.5	178.4	104.0	225.2	109.5	255.9	119.6	171.4	169.0
February	232.1	113.8	178.6	104.2	225.6	109.3	257.0	120.1	171.8	169.3
March	232.9	114.1	178.9	104.3	225.8	109.4	258.1	120.6	172.1	169.6
April	233.5	114.4	179.1	104.5	226.3	109.6	259.1	121.0	172.8	170.0
May	234.2	114.7	179.3	104.6	226.8	109.9	260.2	121.4	173.4	170.4
June	235.0	115.1	179.5	104.8	227.4	110.1	261.3	121.9	174.0	170.9
July	236.0	115.4	179.8	104.9	228.0	110.4	262.7	122.3	174.5	171.3
August	236.9	115.7	180.1	105.0	228.6	110.7	264.0	122.8	175.0	171.6
September	237.8	116.1	180.4	105.0	229.2	111.1	265.3	123.3	175.5	172.0
October	238.7	116.5	180.8	105.4	229.8	111.3	266.4	123.7	176.1	172.4
November	239.5	116.9	181.2	105.7	230.4	111.7	267.5	124.2	176.8	172.9
December	240.3	117.4	181.5	106.1	231.0	112.1	268.6	124.7	177.5	173.4

Fore. = November Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections

MISCELLANEOUS

	Merchandise Trade Balance		Leading Indicators		Estimated GNP		Estimated GNP (1972 \$)		IVA (annual rate)	
	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.
July 1985	-10.51	-10.51	168.7	168.7	3885	3997	1676	3566	6.7	6.7
August	-9.90	-9.90	170.1	170.0	3921	4021	1687	3590	6.8	6.8
September	-11.50	-15.50	171.0	170.6	3942	4033	1691	3594	4.8	1.8
October	-10.68	-11.47	171.1	171.3	3967	4037	1694	3582	2.2	-6.2
November	-10.92	-13.68	171.3	171.5	3992	4068	1700	3600	-3.5	-9.7
December	-11.16	-14.27*	171.9	173.6*	4016	4120	1706	3639	-6.5	-14.4
January 1986	-11.01	-12.83	171.6	173.0	4043	4130	1711	3644	-3.6	-5.7
February	-11.96	-12.72	171.9	172.6	4067	4146	1714	3649	-0.9	1.3
March	-11.44	-12.89	172.2	173.0	4101	4159	1723	3648	0.5	4.9
April	-10.27	-12.93	171.8	173.4	4122	4181	1727	3659	1.2	6.8
May	-11.46	-12.72	171.5	173.3	4144	4206	1729	3670	2.1	6.3
June	-12.21	-11.84	172.2	173.8	4157	4233	1728	3683	1.8	5.2
July	-9.73	-11.63	171.6	173.5	4176	4255	1729	3693	0.5	4.7
August	-11.48	-10.97	170.9	173.2	4197	4279	1731	3704	-3.6	3.9
September	-11.32	-10.73	170.8	172.8	4218	4305	1733	3716	-6.5	1.6
October	-11.20	-10.58	170.3	172.9	4239	4327	1736	3723	-6.5	-2.3
November	-10.96	-10.43	170.9	172.5	4262	4355	1739	3735	-7.3	-2.9
December	-10.04	-10.59	171.3	172.8	4286	4383	1743	3746	-7.8	-4.6

Fore = November Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

FINANCIAL MARKETS

	Monetary Base		M1		M2		Federal Funds		T-Bills (6 Mos.)	
	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.
July 1985	228.0	227.9	595.8	595.8	2490.5	2490.6	7.88	7.88	7.16	7.16
August	229.3	229.4	605.9	605.9	2513.7	2514.0	7.90	7.90	7.32	7.32
September	231.3	231.3	611.7	611.9	2528.4	2528.8	7.92	7.92	7.42	7.27
October	231.7	231.3	610.5	611.1	2540.5	2532.8	7.95	7.99	7.40	7.33
November	232.8	232.7	612.6	617.9	2557.1	2546.8	8.15	8.05	7.58	7.30
December	234.0	235.0	615.3	624.5	2573.6	2563.1	8.29	8.27	7.64	7.09
January 1986	235.4	236.6*	619.1	627.7*	2590.4	2584.3*	8.25	7.99*	7.66	7.13*
February	236.8	237.8	622.3	631.4	2606.8	2602.4	8.36	7.76	7.79	7.02
March	238.1	238.6	625.3	632.3	2623.2	2618.0	8.50	7.52	7.92	6.91
April	239.3	239.5	628.2	633.5	2640.4	2631.1	8.59	7.53	7.98	6.87
May	240.5	240.8	630.6	635.7	2655.2	2646.9	8.55	7.59	7.95	6.95
June	241.7	242.3	633.0	639.7	2667.3	2668.1	8.42	7.43	7.86	6.82
July	243.0	243.2	635.0	640.8	2682.3	2684.1	8.26	7.40	7.74	6.77
August	244.3	244.2	637.9	642.2	2700.3	2697.5	8.12	7.53	7.63	6.88
September	245.6	245.5	640.8	644.4	2719.6	2713.7	8.01	7.51	7.46	6.92
October	247.0	246.9	644.4	649.3	2738.5	2732.7	7.86	7.35	7.45	6.76
November	248.3	248.1	648.3	652.5	2755.0	2751.8	7.71	7.39	7.43	6.83
December	249.6	249.4	650.7	655.9	2772.1	2771.0	7.59	7.30	7.41	6.73

	Aaa (Seasoned)		Municipals (Bond Buyer)		(3 Month) Commercial Paper		90 Day CD's		Prime Rate	
	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.
July 1985	10.97	10.97	8.81	8.81	7.56	7.56	7.74	7.74	9.50	9.50
August	11.05	11.05	9.13	9.08	7.72	7.72	7.81	7.81	9.50	9.50
September	11.07	11.07	9.32	9.32	7.83	7.83	7.93	7.93	9.50	9.50
October	11.08	11.02	9.25	9.08	7.82	7.80	7.90	7.88	9.50	9.50
November	11.20	10.55	9.30	8.54	8.16	7.77	8.26	7.81	9.50	9.50
December	11.38	10.16	9.36	8.43	8.30	7.75	8.42	7.80	9.50	9.50
January 1986	11.40	10.06*	9.39	8.11*	8.14	7.73*	8.27	7.86*	9.88	9.50*
February	11.46	9.86	9.46	7.89	8.35	7.65	8.49	7.77	10.00	9.50
March	11.51	9.64	9.52	7.71	8.46	7.55	8.63	7.70	10.00	9.37
April	11.63	9.73	9.64	7.83	8.50	7.57	8.67	7.66	10.11	9.00
May	11.65	9.88	9.66	8.00	8.46	7.63	8.65	7.72	10.50	9.00
June	11.55	9.63	9.63	7.76	8.37	7.46	8.49	7.55	10.50	9.00
July	11.48	9.51	9.53	7.66	8.15	7.38	8.36	7.46	10.39	9.00
August	11.36	9.84	9.37	7.96	8.07	7.59	8.29	7.73	10.00	9.00
September	11.21	9.75	9.19	7.83	7.96	7.53	8.17	7.67	10.00	9.00
October	11.07	9.56	8.99	7.65	7.85	9.32	8.02	7.46	10.00	9.00
November	10.96	9.68	8.82	7.79	7.63	7.40	7.86	7.54	9.51	9.00
December	10.85	9.56	8.68	7.65	7.56	7.28	7.69	7.37	9.50	9.00

Fore. = November Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections

Georgia State University

a unit of the university system of georgia

university plaza
atlanta, georgia 30303-3083

college of business administration
economic forecasting center
404 658-3282

MONTHLY PROJECTIONS February 1986

Dr. Donald Ratajczak, Director
For Release: March 13, 1986

FALLING OIL PRICES ASSURE NON-INFLATIONARY GROWTH INTO SUMMER

Oil prices were expected to fall in our November and February forecasts, but prices were expected to stabilize at about \$21 per barrel. In fact, oil prices have fallen to the low teens. This raises two questions: Why have oil prices fallen farther than anticipated, and what does such a sharp oil decline mean for the economic outlook?

Much of the turmoil in oil prices can be traced to late December, when Saudi Arabia decided that it no longer would be the swing producer that would ensure the contract price for OPEC oil. This decision by Saudi Arabia immediately increased the world supply of oil by 2.5 million barrels per day. At the same time, a more mild winter than normally anticipated led to an additional 0.5 million barrel decrease in oil demand in the northern hemisphere. The combined effects of the Soviet Natural gas pipeline and increased nuclear power in Europe reduced demand by another 0.8 million barrels per day. Of course, other nations also increased their production once oil prices began tumbling. Indonesia added 0.2 million to daily production while Nigeria, Iraq, Iran and other producers probably increased their production by an additional one million barrels. The Soviet Union, which had reduced production last year because of supply problems from its Siberian fields, began increasing oil supplies once again to Europe. On balance, increased supply and decreased demand created approximately a 10% excess supply of oil and oil products.

In the short-run, the price responsiveness of the oil market is between 0.2 and 0.3. At the extreme, this would mean that the shift in oil supply would generate up to a 50% reduction in oil prices. Thus, the contract price could tumble to the vicinity of \$14 per barrel. It is more likely, however, that the prevailing price for such an excess should have fallen no lower than about \$18 per barrel.

The additional plunge in oil prices to less than \$12 temporarily in early March was caused by the reaction of oil traders. Worldwide, nearly two billion barrels of oil and oil products is held in inventory at any point in time. Many of these oil traders were reluctant to accept a large inventory loss on the pro-

duct they held in storage. Therefore, upon the realization that Saudi Arabia no longer would support prices, many of these dealers dumped their inventory on the world markets. Somewhere between 150 million and 200 million barrels of oil products immediately were dumped by the oil traders. This one-time additional supply could not readily be absorbed and forced prices sharply lower. Indeed, until this additional inventory is absorbed, prices will continue to fall.

On the other hand, any move by OPEC to reduce production or any change in desired inventories by oil traders as seasonal demand naturally begins to rise in the summer months, could quickly absorb this additional excess supply generated by released inventory holdings. As a result, the plunge in prices to \$12 per barrel almost certainly will be temporary. A rebound in prices to more than \$15 should be expected in the second half of 1986.

More significantly, the long-run price responsiveness in the oil markets greatly exceeds the short-run price responsiveness. While short-term elasticities are between 0.2 and 0.3, long-run elasticities appear to be greater than 0.7. Thus, oil prices will gradually rise from these unusually low levels in the absence of further fundamental increases in excess supply until prices stabilize in the low 20s. Indeed, by the end of 1987, oil prices may be in excess of \$21 per barrel and will be rising. The lowest oil prices for the remainder of the century probably are currently being quoted on the futures markets.

Nevertheless, oil prices probably will average about \$15 per barrel in 1986 before rising to \$20 per barrel average in 1987. Such a plunge in oil prices will also generate weakness in natural gas and cause some concessions in coal prices as well. In the first two months of 1986, the fuel component of the PPI fell by 10%. Before the full impact of declining oil prices has run its course, this fuel component is expected to be 25% lower than year-end 1985 levels. Because fuel receives a .16 weight in the Producers' Price Index, these plunging prices will cause a 4.0 percentage point decline in producers' prices from what they otherwise would be. Of course, the falling dollar implies that the Producers Price Index would accelerate to an increase of 2.5% or slightly more in the absence of changes in oil prices. With the decline in oil prices, the PPI for finished goods now is expected to decline 1.5% for all of 1986.

Although not all of the decline in prices of finished goods will be transmitted into the commodity component of the CPI, nearly all will. Thus, prices for CPI commodity components are expected to fall 1% in 1986. With more moderate CPI changes than anticipated, wage pressures probably will remain moderate and should fall below earlier projected gains. This will tend to restrain prices of the service component. Therefore, service inflation probably will slow slightly to between four and 4.5% from the more than 5% that has prevailed in the past few years. When all of these factors are combined, both the CPI and the GNP deflator are expected to grow about 2% in 1986.

One interesting economic note follows from this analysis. Monetarists maintain that exogenous shocks in prices of commodities should have no impact upon overall inflation after adjustment. Any weakness in oil prices should lead to increased price pressures on other commodities. While some acceleration in commodity inflation is apparent where commodities are traded on international markets, there appears to be little pressure for intensifying inflationary pressures in other commodities to offset the weakness in oil. In fact, the plunge in oil prices will permit more moderate money growth for any given level of real economic activity than otherwise would prevail. As the quantity of

money slows its rate of growth during this period of plunging oil prices, the Federal Reserve will be in a position to maintain or even encourage reduced interest rates without seriously violating any money growth targets. Indeed, this type of response will generate lower inflationary pressures in 1987 than would have occurred in the absence of plunging oil prices. Nevertheless, when oil prices stabilize and then begin retracing a portion of their downward trajectory, inflation rates will intensify next year.

The plunge in oil prices has led to a significant decrease in inflationary pressures for all commodities. This, in turn, has increased the attractiveness of financial assets, especially fixed income instruments. Certainly, a one-time exogenous shift in oil prices should not be responsible for removing nearly three percentage points from the inflationary anticipations of long-term bond holders. Yet, yields on long-term government bonds have declined by nearly three percentage points in the past six months. The major reason for this dramatic decline in interest rates is the shift in bond inventory holdings by bond dealers. Until the fall, many dealers felt that interest rates could soon move higher. As a result, they were anticipating inventory losses for the bond holdings that they normally hold in order to maintain orderly markets. This explains why yields on long-term bonds were more than two percentage points higher than the borrowing costs needed to finance those inventories.

When it became clear that interest rates could fall, thus generating inventory profits, bond holders rapidly moved to raise their inventories until yields on those bonds no longer were higher than the borrowing costs of maintaining bond inventories. Indeed, investors actually bid the price of long-term government bonds below the borrowing cost of financing that inventory. This indicated that sentiment had shifted toward capital gains anticipations rather than capital loss fears. These gains were expected to be generated by declining short-term interest rates. The Federal Reserve did lower the discount rate, thereby justifying the initial beliefs of bond speculators. At the present time, with long-term government bonds yielding 7.9%, speculators are again anticipating a further reduction in the discount rate and in short-term borrowing changes. Our projections indicate that they will not be disappointed.

On the other hand, there is little likelihood that short-term interest rates will fall considerably further than the one additional discount rate cut that is anticipated in the projections. If so, long-term government bonds should fall to yields consistent with the borrowing costs of bond inventories. This would suggest that the low-point on the long-term bond market is approximately a yield of 7.75%. Thus, further capital gains appreciation appears to be minimal at the present time.

The decline in short-term interest rates slightly increases profit opportunities in 1986. However, profit gains after adjustment for IVA and capital consumption adjustment still should be less than 15%. Such a modest upward adjustment in profits would not lead to any significant upward adjustment in equity values. However, the plunge in long-term government bond yield to less than 8% exceeds earlier projections by more than a full percent. As a result, equity values could increase by 15% more than expected in our previous projections. Therefore, a Dow Jones average approaching 2000 is not out of the question for 1986.

Quarterly Profile of GNP

	<u>1985-4</u>	<u>1986-1</u>	<u>1986-2</u>	<u>1986-3</u>	<u>1986-4</u>	<u>1987-1</u>	<u>1986</u> <u>Annual</u>
Real:	1.2	4.8	5.5	2.9	3.9	1.5	3.5
Price:	3.3	1.8	-0.6	2.9	3.3	4.4	2.0
Nominal:	4.5	6.8	4.8	5.7	7.3	5.7	5.8

Monthly Statistical Highlights for February 1986

Personal income +0.4%; savings rate 4.1%; personal-consumption +0.2%; retail sales -0.4%; housing starts -11.7%; housing permits -6.3%; construction expenditures +0.1%; business inventories +0.4%; orders for durable goods -0.2%; orders for nondefense capital goods +6.5%; industrial production -0.3%; CPI -0.4%; PPI -0.7%; consumption deflator -0.2%; leading indicators +0.2%; real GNP +3.4%; M1 +5.9%; M2 +3.8%.

Monthly Statistical Highlights for March 1986

Payroll employment 215,000; index of hours worked +0.2%; household employment +293,000; civilian unemployment rate 7.1%; personal income +0.6%; savings rate 4.6%; personal consumption +0.1%; retail sales -0.9%; auto sales 10.0 million; housing starts 0.8%; housing permits -1.5%; construction expenditures 2.0%; business inventories +0.4%; orders for durable goods +1.0%; orders for nondefense capital goods +4.8%; industrial production +0.3%; CPI -0.3%; PPI -0.6%; consumption deflator -0.3%; leading indicators +0.5%; real GNP +6.8%; M1 +6.1%; M2 +6.2%.

COMMENTARY

Employment - Part of the February increase in unemployment appears to be associated with a misinterpretation of an unemployment survey question during January that was rectified in February. As a result, the January unemployment rate probably should not have fallen by 0.2 percentage points. Another reason for the sharp increase in unemployment in February was the flooding in California that may have largely been responsible for the sharp increase in unemployment of agricultural workers. These workers are expected to be re-employed when the flooding subsides in March and April. Also, January was an unusually severe month both in 1985 and in 1984. Therefore, seasonal factors probably led to overstating the significance of gains in employment and hours during that month. Therefore, a portion of the weakness observed in February means nothing more than adjusting for these excessive seasonal factors. If these arguments are correct, employment and the index of hours worked should once again move forward in March.

Of course, some areas of weakness are fundamental. The 15,000 job loss in oil and gas exploration will be compounded by further reductions in the next few months. Some of the weakness in transportation equipment also will intensify as the industry reduces auto assembly activity in order to adjust for excessive inventories.

The hourly earnings index once again accelerated in February, but the index currently is growing less than had been anticipated in our forecast and probably will continue to underperform forecasted values for the remainder of this year.

Personal Income & Outlays - Special factors led to the significant decline in personal income during January. A \$13 billion reduction in farm income upon termination of some subsidy programs accounted for most of the weakness. In addition, government payroll increases that intensified December gains had no further impact in generating January increases. Finally, the annual inclusion of social security tax changes also held down the January estimates. Flooding in California probably will cause rental income to fall while declining interest rates will re-establish a downtrend in interest receipts. Nevertheless, a moderate gain in personal income is anticipated in February. It is clear, however, that reduced wages and more moderate growth in the index of hours worked will lead to considerably lower levels of personal income early in 1986 than contained in the February forecast.

The plunge in energy prices will be reflected in apparent weakness in retail sales activity. In addition, automobile sales slowed markedly after the special 7.9% financing incentives were removed in the last 10 days of February. This weakness in sales is expected to continue in March although the re-establishment of some incentives will cause a less abrupt decline in sales than expected in the forecast.

However, plunging energy prices will significantly restrain nondurable goods sales. As a result, retail sales are expected to decline both in February and March. As a result of this weakness, consumption expenditures before inflationary adjustment should show only modest increases. The source of any increases that materialize will be in the service component. It should be noted, however, that after inflationary adjustments, consumption will be growing acceptably in the first quarter. Indeed, consumer spending may exceed forecasted values after adjustment for inflation. This anomaly is created by the dramatic decline in oil prices. As a result of that decline, the Consumer Price Index is expected to fall both in February and March. In addition, the consumption deflator is expected to begin declining and continue falling into April. As a result of these price weaknesses, the GNP deflator is expected to actually decline modestly in the second quarter. Thus, the apparent weakness in expenditures will largely reflect weak prices rather than weak volumes.

Construction - Unusually mild weather accounted for a huge surge in single-family starts during January. The especially wet weather in the west will detract from starts in February. Nevertheless, sharp declines in mortgage rates should generate a healthier single-family housing market than originally projected. Housing starts will exceed 1.8 million units in 1986. We are still expecting that tax reform possibilities will significantly diminish rental activities later in the year and into 1987.

Although nonresidential construction surged at the end of 1985, orders for nonresidential construction are now falling sharply. In the past three months, orders have fallen by more than 20%. This should prevent any significant rebound in nonresidential expenditures in 1986. Thus, the stronger than originally anticipated gains for residential construction will be offset by weaker gains in nonresidential activity. The public sector will also struggle as a result of the inability to sell tax exempt bonds. In addition, the phasing out of general revenue sharing toward the end of 1986 is expected to restrain capital spending programs in the government sector.

Business Activity - In December, an unusual increase in orders for commercial aircraft helped to support orders for all durable goods. In January, the

aircraft orders were absent but a surge in defense orders was able to hold up orders for all durable goods. In February, a moderate rebound in orders for nondefense capital goods should develop, but declining defense orders should prevent any gains in orders for all durable goods. Because of a sharp plunge in shipments for both nondefense and defense capital goods, both sectors will be hard pressed to show any significant expansion in the first quarter of 1986.

Manufacturing inventories continued to liquidate in January. This liquidation is expected to gradually ease, although employment activity suggests that liquidations continued February. However, excess auto inventories began developing late in the month, causing a surge in inventories for retail goods. Significant further surges in retail inventories are expected in March, causing a significant expansion in business inventories.

Weakness in manufacturing should be reflected in declining industrial production during February. However, a rebound in production of materials, business equipment, and defense and space all should lead to an increase in industrial production in March.

Prices - The plunge in oil prices is readily apparent in the price indices for consumer nondurables and in the overall CPI and PPI estimates. As a result of oil price weakness, these indicators will be slightly lower in June than they were in December. Inflation will rebound in the second half of 1986, probably growing at a 4% rate. Nevertheless, inflation now is expected to grow only 2% for all of 1986.

Miscellaneous - Because of the absence of orders for commercial aircraft in January, the leading indicators showed an unexpected decline. In February, only a modest increase is anticipated despite a significant surge in stock market values. By March, however, further stock market gains along with a surge in the money stock after adjustment for declining prices will contribute significantly to the leading indicators. Real money stock growth also will be a significant contributor to the leading indicators through the remainder of the spring. However, orders for capital goods are not expected to grow significantly from current levels while building permits also are expected to gradually fade. Thus, the leading indicators probably will turn trendless in the spring and show no significant movement during the summer.

Declining oil prices will be reflected in a narrowing trade balance deficit in the coming months. However, the volume of imports will continue to grow through the spring. Trade balances are expected to then more fundamentally narrow later in 1986 and into 1987.

Sharp swings in the IVA measure are caused by inventory profits, especially in the energy industries. A temporary surge in inventory profits developed in the fourth quarter but the plunge in oil prices almost certainly is creating dramatic inventory losses in the spring. These inventory losses should persist into the summer months before gradually being reconverted to inventory profits once again toward the end of the year, especially in those commodities which are traded in international markets.

Financial Markets

The sharp reduction in inflationary pressures appears to be the dominant force leading toward significant reductions in credit market pressures in recent weeks. Before oil prices began declining, more than \$70 billion of energy materials was held in inventory. When these products are fully replaced, financing requirements will be reduced by nearly \$25 billion. As a result, commercial paper outstanding could decline by more than \$20 billion. In addition, corporations have become excited by the availability of financing in the long-term market. As a result, more than \$7 billion of long-term corporate issues have been coming to market weekly. The result of this heavy borrowing is to reduce short-term credit market instruments. As a result, commercial paper rates are expected to fall to less than 7% in the spring. This will place further downward pressures upon the federal funds rate and may require the Federal Reserve to lower the discount rate one more time. As a result, the prime rate is now expected to fall to 8.5% by mid-spring. As mentioned above, the long-term government bond probably will encounter difficulty when it reaches a yield of 7.75%. However, there is no reason to expect a significant rebound in long-term bond yields until the fall, when inflationary pressures begin to reappear.

Actually, our analysis by sector suggests that interest rates should fall in the spring. The corporate sector will be sharply reducing inventory borrowings even as it gradually increases inventory investments. This is because the dollar value of inventory has been significantly reduced by falling prices. At the same time, corporate profitability assures that the corporate sector can self-finance its investment requirements. Therefore, corporations will be backing away from the credit market through the spring and into the summer months.

The government probably has reached a peak level of borrowing in the fall following the ending of borrowing restraints. Plunging oil prices and declining interest rates will reduce the government deficit for fiscal year 1987, probably to as low as \$165 billion before significant Gramm-Rudman efforts develop. Thus, the government sector also will be gradually reducing its heavy burdens upon the credit markets. State and local governments have been effectively precluded from the tax-exempt market because of a "ridiculous" provision in the tax-reform legislation. This may be reducing the capital spending programs of these governments, resulting in lower burdens upon credit markets than otherwise would be anticipated.

Even the household sector is beginning to increase savings following the termination of especially favorable finance conditions. Also, plunging oil prices will create a period of unanticipated savings for the household sector. The surge in household savings to 4.6% in March is almost exclusively the result of declining gasoline prices. Thus, all the sectors except foreign investors would indicate a significant decline in interest rates through the spring and into the summer months. Such a decline is being projected at the present time.

Nevertheless, the low point anticipated for the long-term bond is probably a yield of 7.75%. This would mean a yield of slightly more than 9% for the FAA and for conventional mortgage rates.

Equity Markets

As mentioned above, the decline in long-term interest yields to less than 8% increases the likelihood that stock market prices could grow above 1900 and approach the 2000 level. While these index numbers appear to be wildly excessive, it must be noted that bond yields have fallen by nearly 30% in six months, while the decline in financial costs will generate operating profits less tax liabilities that should increase nearly 15%. Thus, a one-time 45% spurt in equity values appears to be justified by prevailing economic conditions. The stock market probably will reach these higher points in the spring and then begin trending downward when long-term bond yields begin to rise.

EMPLOYMENT

	Payroll Employment		Index of Hours Worked		Household Civilian Employment		Civilian Unemployment Rate		Hourly Earnings Index	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October 1985	98559	98559	117.4	117.4	107813	107813	7.1	7.1	166.4	166.4
November	98739	98801	117.5	117.6	107969	107969	7.0	7.0	167.1	167.1
December	99059	99086	118.3	118.1	108206	108206	6.9	6.9	168.4	168.4
January 1986	99274	99507	118.6	119.3	108592	108955	6.8	6.7	169.2	167.5
February	99553	99733	119.0	118.9	108806	108561	6.9	7.3	170.0	168.5
March	99835	99948*	119.4	119.2*	109074	108854*	6.7	7.1*	170.9	169.1*
April	99986	100101	119.5	119.4	109265	109144	6.6	7.0	171.2	169.5
May	100184	100319	119.7	119.6	109532	109367	6.6	7.0	171.4	170.0
June	100380	100420	120.0	119.7	109799	109522	6.5	7.0	171.7	170.4
July	100617	100697	120.3	120.0	110013	109910	6.6	6.8	172.3	170.8
August	100872	100881	120.6	120.2	110184	110109	6.6	6.8	172.9	171.3
September	101127	100982	120.9	120.3	110329	110245	6.7	6.9	173.5	171.8
October	101256	101217	120.8	120.6	110483	110509	6.6	6.8	174.0	172.4
November	101403	101393	121.0	120.8	110729	110710	6.5	6.8	174.3	173.0
December	101382	101645	120.9	121.1	110843	111006	6.6	6.7	174.7	173.6
January 1987	101559	101822	121.2	121.3	111019	111219	6.5	6.7	175.6	174.3
February	101791	101998	121.5	121.5	111238	111411	6.5	6.7	176.5	175.0
March	102030	102175	121.8	121.7	111442	111581	6.5	6.7	177.3	175.7

PERSONAL INCOME

	Personal Income		Wage & Salary		Personal Savings		Disposable Income		Personal Outlays	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October 1985	3.331	3.330	1.991	1.992	127.8	127.8	2.825	2.825	2.698	2.698
November	3.347	3.347	2.003	2.004	120.3	121.0	2.838	2.838	2.717	2.717
December	3.394	3.386	2.025	2.022	106.1	99.1	2.879	2.873	2.773	2.774
January 1986	3.396	3.383	2.035	2.028	107.9	114.1	2.888	2.879	2.780	2.765
February	3.418	3.397*	2.048	2.035*	118.8	119.2*	2.907	2.890*	2.788	2.770*
March	3.440	3.417	2.062	2.048	149.8	132.5	2.926	2.906	2.776	2.773
April	3.455	3.436	2.071	2.058	144.3	135.1	2.937	2.921	2.793	2.785
May	3.471	3.455	2.079	2.069	134.7	138.8	2.949	2.936	2.815	2.797
June	3.487	3.471	2.088	2.078	122.7	136.2	2.962	2.948	2.839	2.812
July	3.505	3.489	2.100	2.089	118.5	136.4	2.973	2.962	2.855	2.826
August	3.522	3.509	2.112	2.101	123.1	137.5	2.985	2.978	2.862	2.841
September	3.539	3.525	2.125	2.110	117.8	134.7	2.997	2.990	2.879	2.855
October	3.558	3.547	2.132	2.125	120.7	134.0	3.011	3.008	2.890	2.874
November	3.578	3.567	2.139	2.137	118.8	132.7	3.027	3.024	2.908	2.891
December	3.599	3.591	2.146	2.152	114.0	140.8	3.044	3.044	2.930	2.903
January 1987	3.607	3.610	2.160	2.165	145.4	170.8	3.089	3.092	2.944	2.921
February	3.631	3.633	2.174	2.179	150.2	172.8	3.112	3.111	2.961	2.938
March	3.656	3.655	2.199	2.192	154.8	171.8	3.134	3.129	2.979	2.957

Fore. = February Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

CONSUMPTION

	Personal Consumption		Durables		Nondurables		Services		Consumption Real	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October 1985	2603.1	2602.7	48.2	348.2	926.0	926.0	1328.9	1328.5	2301.6	2313.5
November	2621.7	2621.7	353.9	354.0	926.5	925.3	1341.3	1342.5	2303.8	2318.3
December	2675.1	2677.6	375.7	378.8	935.7	934.4	1363.7	1364.3	2342.5	2359.1
January 1986	2681.6	2667.0	380.5	376.5	939.6	930.1	1361.5	1360.4	2352.3	2344.4*
February	2687.7	2671.9*	378.2	371.6*	941.3	930.7*	1368.2	1369.6*	2359.7	2352.8
March	2673.7	2673.8	357.9	368.4	940.0	929.0	1375.8	1376.4	2345.4	2360.9
April	2689.5	2685.4	365.6	372.4	941.2	929.8	1382.7	1383.2	2351.0	2374.7
May	2709.8	2696.4	368.1	372.7	947.9	932.9	1393.8	1390.8	2358.4	2382.2
June	2733.0	2710.2	370.7	371.6	957.3	939.7	1405.0	1398.9	2370.3	2389.9
July	2746.7	2723.3	373.5	373.2	959.6	942.6	1413.6	1407.5	2376.0	2395.1
August	2752.6	2737.5	377.2	375.8	955.3	945.4	1420.1	1416.3	2375.0	2400.3
September	2768.7	2751.5	380.9	377.7	961.5	950.1	1426.3	1423.7	2382.7	2405.6
October	2778.3	2769.4	376.2	383.7	966.3	953.6	1435.8	1432.1	2380.7	2414.6
November	2794.5	2785.9	375.8	385.5	971.4	958.6	1447.3	1441.8	2386.4	2421.6
December	2815.0	2796.9	378.7	384.3	976.9	962.0	1459.4	1450.6	2395.7	2421.7
January 1987	2827.6	2814.0	380.6	388.4	980.8	965.7	1466.2	1459.9	2396.3	2427.0
February	2843.8	2830.1	382.8	391.0	984.0	969.6	1477.0	1469.5	2399.8	2432.2
March	2860.2	2846.1	385.1	392.9	987.3	974.9	1487.8	1480.3	2405.6	2437.5

RETAIL SALES

	Retail Sales		Non-Auto Durables		Auto (Million Units)		Nondurable Sales		Auto Sales	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October 1985	114.86	114.86	17.37	17.37	9.6	9.6	72.94	72.94	24.55	24.55
November	115.62	115.41	17.39	17.34	9.8	9.8	73.40	73.22	24.83	24.85
December	117.86	117.41	17.79	17.79	11.5	11.5	73.83	73.68	26.24	25.93
January 1986	119.05	117.50	18.02	17.83	11.5	11.5	74.20	73.50	26.83	26.17
February	118.51	116.98*	18.22	17.90*	11.0	10.6	74.33	73.55*	25.96	25.53*
March	116.62	116.46	17.92	18.03	9.3	10.0*	74.23	73.41	24.47	25.02
April	117.22	117.00	18.12	18.15	9.4	10.2	74.32	73.48	24.78	25.37
May	118.04	117.28	18.16	18.32	9.6	10.1	74.85	73.72	25.03	25.24
June	119.09	117.69	18.09	18.41	9.9	9.9	75.59	74.26	25.41	25.02
July	119.60	118.10	18.26	18.58	10.0	9.8	75.77	74.49	25.57	25.03
August	119.60	118.63	18.34	18.55	10.3	10.0	75.44	74.71	25.82	25.37
September	120.41	119.22	18.56	18.69	10.3	10.0	75.92	75.08	25.93	25.45
October	120.44	120.20	18.72	18.73	9.7	10.1	76.30	75.36	25.42	26.11
November	120.81	120.80	18.79	18.92	9.6	10.0	76.71	75.75	25.31	26.13
December	121.58	120.93	18.49	18.90	9.9	9.9	77.14	76.02	25.95	26.01
January 1987	122.11	121.70	18.52	18.85	10.0	10.2	77.45	76.31	26.14	26.54
February	122.62	122.31	18.61	18.99	10.1	10.3	77.70	76.62	26.31	26.70
March	123.15	122.96	18.69	19.13	10.2	10.3	77.96	77.04	26.50	26.79

Fore. = February Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

CONSTRUCTION

	Housing Starts		Single Family Starts		Housing Permits		Construction Expenditures (Current)		Construction Expenditures (Real)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October 1985	1 772	1 784	1 120	1 118	1 688	1 688	346.3	346.1	204.8	204.7
November	1 566	1 654	0 961	1 006	1 661	1 661	348.1	345.1	206.2	204.3
December	1 840	1 804	1 113	1 087	1 844	1 873	349.4	354.0	206.9	209.6
January 1986	1 869	2 088	1 182	1 353	1 792	1 870	353.8	357.3	209.0	211.0
February	1 854	1 843*	1 106	1 142*	1 726	1 753*	356.2	357.6*	210.1	210.6*
March	1 838	1 857	1 111	1 163	1 695	1 726	359.1	364.6	211.7	214.3
April	1 808	1 929	1 107	1 238	1 652	1 759	360.0	366.7	211.8	215.1
May	1 801	1 927	1 103	1 259	1 629	1 788	360.2	365.2	211.1	213.7
June	1 796	1 941	1 099	1 268	1 634	1 792	361.4	366.3	211.2	213.8
July	1 743	1 915	1 076	1 243	1 596	1 756	363.9	367.3	212.1	213.9
August	1 718	1 866	1 082	1 221	1 543	1 721	366.2	368.8	212.9	214.3
September	1 701	1 860	1 085	1 218	1 542	1 703	368.4	369.2	213.7	214.0
October	1 673	1 792	1 093	1 168	1 492	1 654	368.4	368.8	212.9	213.3
November	1 651	1 814	1 109	1 193	1 491	1 678	368.5	369.3	212.0	213.0
December	1 668	1 821	1 122	1 207	1 490	1 680	368.8	368.9	211.3	212.1
January 1987	1 681	1 811	1 139	1 205	1 517	1 662	369.9	368.7	211.4	211.3
February	1 689	1 775	1 146	1 192	1 543	1 643	370.2	369.5	210.9	211.1
March	1 697	1 747	1 152	1 176	1 554	1 609	370.7	369.5	210.7	210.4

	Non-Residential		Public Construction		Residential Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October 1985	132.1	132.2	63.6	62.8	150.6	151.1
November	133.4	132.8	64.5	62.5	150.3	149.7
December	134.3	138.9	65.1	64.5	150.0	150.6
January 1986	134.6	137.8	66.3	66.7	152.9	152.8
February	133.9	136.9*	67.4	66.2*	154.9	154.5*
March	133.9	136.8	68.2	66.8	157.0	161.0
April	134.7	137.6	68.3	67.3	157.0	161.8
May	135.6	137.9	68.0	67.6	156.6	159.7
June	136.4	136.8	67.7	68.0	157.3	161.5
July	136.3	136.9	68.7	68.2	158.9	162.2
August	136.8	137.6	69.4	68.5	160.0	162.7
September	137.2	138.3	70.0	69.0	161.2	161.9
October	138.1	138.7	69.5	69.2	160.8	160.9
November	139.0	139.1	69.0	69.5	160.5	160.7
December	139.9	139.0	68.4	69.3	160.5	160.6
January 1987	140.0	138.7	69.0	69.0	160.9	161.0
February	140.0	137.9	69.7	69.6	160.5	162.0
March	139.6	137.5	70.3	70.1	160.8	161.9

Fore. = February Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

PRICES

	CPI-U		PPI		PPI-Industrial		Estimated GNP	
	(seasonally adjusted)		Finished Goods (seasonally adjusted)		Commodities (unadjusted)		Deflator	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October 1985	324.6	324.6	294.4	294.3	324.4	324.4	112.7	112.6
November	326.2	326.2	296.7	296.7	325.0	325.0	113.0	113.0
December	327.8	327.8	297.9	297.9	325.2	325.2	113.2	113.4
January 1986	328.7	328.7	297.3	296.2	323.9	324.0	113.6	113.7
February	328.6	327.5*	296.9	294.1*	322.5	322.7*	113.9	113.5
March	329.1	326.6	296.6	292.3	321.2	321.0	114.2	113.3
April	330.3	326.0	296.9	290.8	321.8	320.6	114.4	113.2
May	331.5	326.5	297.1	291.3	322.2	321.0	114.7	113.3
June	332.7	327.5	297.8	292.2	322.5	321.3	115.0	113.5
July	333.4	328.4	298.4	292.9	322.9	321.8	115.3	113.8
August	334.1	329.7	298.9	294.1	323.2	322.2	115.6	114.1
September	334.8	330.8	299.4	294.0	321.2	320.1	115.9	114.4
October	336.1	331.7	299.9	295.9	323.9	322.9	116.3	114.7
November	337.4	332.6	300.5	296.5	324.8	323.4	116.6	115.0
December	338.7	334.0	301.2	297.5	325.7	324.0	117.0	115.4
January 1987	340.2	335.1	302.0	298.4	326.5	324.8	117.4	115.8
February	341.7	336.5	302.9	299.5	327.0	325.3	117.9	116.2
March	343.3	337.7	303.8	300.6	327.6	326.1	118.3	116.7

	Consumption		Consumer		Consumer		Consumer		Implicit	
	Deflator		Durables		Nondurables		Services		Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October 1985	113.1	112.5	104.7	103.9	108.8	108.3	118.7	118.3	169.0	169.0
November	113.8	113.1	105.2	104.2	109.1	109.1	119.1	118.7	168.8	168.9
December	114.2	113.5	105.6	104.8	109.9	109.8	119.6	119.0	168.9	168.9
January 1986	114.0	113.8*	105.0	105.0*	109.8	110.0*	119.9	119.3*	169.3	169.4
February	113.9	113.6	104.7	104.8	109.5	109.1	120.2	119.6	169.5	169.8*
March	114.0	113.3	104.5	104.9	109.5	107.8	120.5	119.9	169.6	170.1
April	114.4	113.1	104.7	104.9	109.7	107.0	120.9	120.2	170.0	170.5
May	114.9	113.2	104.9	105.1	109.9	106.7	121.6	120.6	170.6	170.9
June	115.3	113.4	105.1	105.0	110.1	106.8	122.2	121.0	171.1	171.3
July	115.6	113.7	105.3	105.2	110.3	107.0	122.8	121.4	171.6	171.7
August	115.9	114.0	105.5	105.4	110.4	107.2	123.2	121.9	172.0	172.1
September	116.2	114.4	105.7	105.6	110.5	107.5	123.6	122.3	172.4	172.5
October	116.7	114.7	106.0	105.7	110.9	107.7	124.1	122.8	173.0	172.9
November	117.1	115.0	106.2	106.0	111.5	108.0	124.8	123.2	173.8	173.4
December	117.5	115.5	106.4	106.2	112.0	108.2	125.5	123.9	174.5	173.9
January 1987	118.0	115.9	106.5	106.6	112.3	108.5	126.0	124.5	175.0	174.5
February	118.5	116.4	106.7	107.0	112.5	108.8	126.5	125.0	175.5	175.0
March	118.9	116.8	106.9	107.3	112.7	109.2	127.1	125.6	175.9	175.6

Fore. = February Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections

BUSINESS ACTIVITY

	Manufacturers' Inventories		Durable Goods Orders		Non-Defense Capital Goods Orders		Non-Defense Capital Shipments	
	Fore. C.E.		Fore. C.E.		Fore. C.E.		Fore. C.E.	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October 1985	282.4	282.4	104.50	104.50	27.09	27.09	27.72	27.72
November	281.8	282.0	103.78	103.80	25.79	25.79	27.77	27.77
December	282.1	281.9	108.16	107.53	31.36	30.57	29.53	28.63
January 1986	282.9	280.7	106.19	108.90	28.42	24.57	29.03	25.70
February	283.7	280.0*	106.93	108.68*	28.65	26.17*	28.96	25.88*
March	284.9	280.8	107.53	109.72	29.13	27.43	29.11	27.36
April	286.2	281.7	107.27	110.13	29.10	27.92	29.15	27.94
May	287.3	282.8	106.78	109.68	28.66	28.59	29.07	28.37
June	288.3	284.0	107.08	109.43	28.93	28.26	29.08	28.58
July	289.5	285.1	107.46	110.21	29.17	29.06	29.12	28.69
August	290.8	286.4	108.13	110.04	29.25	29.17	29.15	28.93
September	292.0	287.8	107.92	109.63	29.02	29.03	29.14	29.04
October	293.5	289.2	107.43	109.27	28.86	28.82	29.12	29.16
November	295.4	291.0	107.16	108.64	28.72	28.69	29.18	29.02
December	297.4	292.4	106.92	108.43	28.78	28.43	29.23	28.69
January 1987	299.2	293.8	106.85	108.29	28.53	28.56	29.09	28.78
February	300.8	295.0	107.11	108.56	28.66	28.79	28.92	28.84
March	302.4	296.8	107.02	109.13	28.51	28.46	29.06	28.69

	Business Inventories		Defense Shipments		Industrial Production		Capacity Utilization	
	Fore. C.E.		Fore. C.E.		Fore. C.E.		Fore. C.E.	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October 1985	582.2	582.2	7.67	7.67	124.4	124.4	79.8	79.8
November	583.4	583.4	7.86	7.86	125.1	125.4	80.1	80.3
December	584.6	582.2	7.87	7.94	126.0	126.3	80.5	80.7
January 1986	585.1	579.3	7.95	7.29	126.8	126.7	80.8	80.8
February	587.6	581.4*	8.10	7.52*	127.0	126.3*	80.8	80.4*
March	589.7	583.6	8.23	7.93	127.2	126.7	80.7	80.5
April	591.4	585.5	8.30	8.05	127.5	127.0	80.7	80.6
May	594.5	587.8	8.33	8.16	127.8	127.3	80.7	80.7
June	597.4	590.2	8.37	8.24	128.1	127.5	80.7	80.7
July	599.1	592.5	8.46	8.27	128.2	127.8	80.6	80.7
August	601.5	594.9	8.57	8.40	128.3	128.0	80.4	80.7
September	603.8	597.3	8.69	8.49	128.5	128.2	80.3	80.6
October	606.4	601.2	8.65	8.54	128.7	128.5	80.2	80.6
November	610.7	605.0	8.60	8.60	128.8	128.7	80.0	80.5
December	615.5	608.2	8.61	8.63	128.7	129.0	79.7	80.5
January 1987	619.4	611.4	8.72	8.70	128.9	129.3	79.6	80.5
February	622.8	614.9	8.81	8.75	128.8	129.5	79.3	80.4
March	626.0	618.7	8.89	8.79	128.9	129.8	79.2	80.4

Fore. = February Forecast

C.E. = Current Expectations

* = This item and those beyond it are expectations

MISCELLANEOUS

	Merchandise Trade Balance		Leading Indicators		Estimated GNP		Estimated GNP (1972 \$)		IVA (annual rate)	
	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.
October 1985	-11.47	-11.45	171.3	171.6	4030	4031	3576	3580	-6.2	-6.2
November	-13.68	-13.68	171.5	172.0	4058	4054	3591	3588	-9.7	-10.2
December	-16.57	-14.37	173.6	174.0	4097	4100	3619	3616	-14.6	-13.6
January 1986	-14.93	-16.46	173.0	173.0	4133	4121	3638	3624	-0.6	-0.3
February	-14.21	-15.62*	172.6	173.3*	4154	4125	3647	3634	4.3	9.6
March	-11.59	-14.93	173.0	174.1	4176	4140	3657	3654	14.0	15.8
April	-13.29	-13.26	173.4	174.3	4198	4161	3670	3676	12.1	15.1
May	-13.85	-13.57	173.3	174.6	4215	4178	3675	3688	6.0	9.3
June	-13.26	-13.84	173.8	174.4	4233	4194	3681	3695	2.3	7.2
July	-13.46	-13.52	173.5	174.0	4254	4213	3690	3702	-1.0	4.1
August	-13.35	-13.29	173.2	174.2	4274	4239	3697	3715	-1.8	2.6
September	-13.23	-13.38	172.8	174.5	4295	4256	3705	3720	-1.9	0.3
October	-13.69	-13.26	172.9	174.0	4319	4295	3714	3744	-4.7	-1.4
November	-13.49	-13.11	172.5	173.5	4346	4313	3727	3750	-9.3	-6.5
December	-13.28	-12.94	172.8	173.1	4375	4327	3739	3749	-14.2	-8.9
January 1987	-13.07	-12.90	172.5	172.5	4396	4347	3744	3754	-12.6	-9.6
February	-12.98	-12.76	171.6	172.8	4414	4373	3744	3763	-10.7	-10.4
March	-12.88	-12.57	171.4	173.0	4433	4397	3747	3767	-8.9	-10.6

Fore. = February Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

FINANCIAL MARKETS

	Monetary Base		M1		M2		Federal Funds		T-Bills (6 Mos.)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October 1985	231.3	231.3	611.1	614.1	2532.8	2538.3	7.99	7.99	7.33	7.33
November	232.7	232.8	617.9	620.0	2546.8	2550.6	8.05	8.05	7.30	7.30
December	235.0	235.5	624.5	626.5	2563.1	2565.5	8.27	8.27	7.09	7.09
January 1986	236.5	235.6	627.3	627.1	2582.7	2569.3	8.06	8.14	7.10	7.16
February	237.0	238.1*	629.2	630.1*	2603.5	2577.4*	7.96	7.86	7.08	7.11
March	237.6	238.9	631.0	633.2	2624.1	2590.3	7.85	7.53*	7.06	6.84*
April	239.2	239.3	633.7	634.2	2636.7	2600.7	7.53	7.02	6.92	6.53
May	240.9	239.9	636.2	635.7	2648.5	2613.7	7.42	6.88	6.89	6.42
June	242.5	241.1	638.6	638.4	2660.5	2629.4	7.31	6.83	6.85	6.36
July	243.8	242.3	641.1	641.1	2681.4	2645.2	7.25	6.85	6.82	6.41
August	245.1	244.0	645.8	645.4	2698.7	2662.9	7.31	6.92	6.86	6.48
September	246.4	245.2	650.5	648.6	2716.0	2681.5	7.37	6.78	6.88	6.39
October	248.0	246.5	653.4	652.5	2734.3	2703.0	7.59	6.97	7.13	6.48
November	249.1	247.8	656.9	655.7	2754.9	2721.9	7.63	6.88	7.21	6.36
December	250.2	249.2	660.4	659.1	2775.4	2741.0	7.68	6.82	7.28	6.29
January 1987	251.8	250.5	663.9	662.6	2791.3	2760.2	7.85	6.99	7.40	6.41
February	253.1	251.8	667.4	665.8	2809.1	2779.5	7.93	7.11	7.46	6.63
March	254.4	253.1	671.1	669.5	2826.9	2801.7	7.82	7.13	7.40	6.58

	Aaa (Seasoned)		Municipals (Bond Buyer)		(3 Month) Commercial Paper		90 Day CD's		Prime Rate	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October 1985	11.02	11.02	9.08	9.08	7.80	7.80	7.88	7.88	9.50	9.50
November	10.55	10.55	8.54	8.54	7.77	7.77	7.81	7.81	9.50	9.50
December	10.16	10.16	8.43	8.43	7.75	7.75	7.80	7.80	9.50	9.50
January 1986	10.05	10.05	8.27	8.08	7.72	7.71	7.84	7.82	9.50	9.50
February	10.12	9.67	8.25	7.44	7.63	7.63	7.75	7.69	9.50	9.50
March	10.08	8.73*	8.09	6.55*	7.56	7.42*	7.71	7.50*	9.50	9.32*
April	9.84	8.39	7.63	6.27	7.52	6.98	7.67	7.07	9.50	8.83
May	9.73	8.27	7.52	6.21	7.28	6.85	7.48	6.93	9.19	8.50
June	9.63	8.34	7.41	6.36	7.16	6.77	7.35	6.85	9.00	8.50
July	9.44	8.43	7.26	6.42	7.11	6.88	7.29	7.01	9.00	8.50
August	9.49	8.60	7.28	6.54	7.26	6.99	7.42	7.11	9.00	8.50
September	9.53	8.46	7.35	6.50	7.42	6.84	7.63	6.97	9.00	8.50
October	9.55	8.65	7.36	6.69	7.65	7.03	7.78	7.15	9.00	8.50
November	9.58	8.58	7.40	6.73	7.72	6.92	7.95	7.01	9.00	8.50
December	9.61	8.46	7.44	6.64	7.79	6.80	8.14	6.93	9.00	8.50
January 1987	9.88	8.59	7.62	6.82	7.93	7.05	8.23	7.18	9.08	8.50
February	9.95	8.83	7.74	6.97	7.99	7.20	8.30	7.33	9.50	8.82
March	9.96	8.69	7.77	6.83	7.95	7.11	8.27	7.22	9.50	9.00

Fore. = February Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections

4/7/86

U1880-3

Georgia State University

a unit of the university system of georgia

university plaza
atlanta, georgia 30303-3083

college of business administration
economic forecasting center
414 654 3082

MONTHLY PROJECTIONS March 1986

Dr. Donald Ratajczak, Director
For Release: March 31, 1986

SLUGGISH OIL AND AUTOS AID DEFLATION IN LOWERING INTEREST RATES

As expected, falling oil prices are causing deflationary forces in the PPI and CPI indices. Especially favorable seasonal factors accentuated the magnitude of deflation in the January and February PPI estimates. As those seasonals reverse in March, PPI prices will show little change. However, oil prices in the CPI will continue to dominate that index through April. Therefore, oil induced deflation certainly will be with us until, at least, May.

What has been partially overlooked, however, has been the impact of plunging oil prices upon desired investment. At \$28 per barrel, more than \$70 billion of energy material inventories were being held in the United States. As those inventories are being exhausted and are being replaced by inventories with half the price tag, about \$25 billion of one-time reductions in inventory investments will be forthcoming. (The decline is only \$25 billion because of the energy materials include natural gas and coal, which are falling in price but not by the magnitude of oil.) In addition, oil exploration is declining sharply. In February, the mining component of industrial production fell 3.3% while unemployment in Texas increased by 143,000. (Normally, oil exploration accounts for approximately 10% of the more than \$350 billion of capital expenditures in the United States. Many of these programs are being slashed by 30%, much of which is occurring through reduced exploration efforts at the present time.) Thus, desired investment probably has decreased by about \$35 billion during the first half of 1986 as a result of the turmoil in the oil markets.

Eventually, the reduced interest rates induced by such a significant shift in investment activity along with the reduced energy cost accompanying other capital spending programs will accelerate to activity elsewhere. Thus, toward the end of 1986 and early in 1987 capital spending programs may be stronger outside the oil patch than originally contemplated. However, any increased investment activity must await increased spending programs, especially by the consumer.

Of course, some of the reduced investment will correspond with diminished savings created by significant inventory losses and falling operating profits in the energy industries. However, as 40% of our energy needs are served by

foreign suppliers, a significant proportion of the profit-loss will be borne by those foreign producers. Therefore, the desire to save at current interest rates and economic activity levels will not diminish by the magnitude of diminished investment activity.

Moreover, the consumer has exhibited a desire to pocket the increased purchasing power that declining energy prices is generating. The personal savings rate, that was \$105.3 billion in December, is projected to rise to \$158.1 billion by April. It is not unusual for the consumer to initially react to changing prices by altering savings. Once the increased savings have accumulated for several months, consumers will begin to demonstrate increased desires to purchase. Moreover, the degree of consumer retrenchment has been substantially overstated. Although retail sales in March are projected to be \$115.75 billion, down from \$116.86 billion in December, real consumption will actually be slightly higher in March than in December because of declining prices.

One area the consumer is showing hesitancy is in automobile sales. First, the consumer appears to be waiting for especially good dealer incentives before buying automobiles. As the especially favorable financial incentives have been replaced by less generous allowances, sales have slumped. They almost have certainly will slump further when GM raises its prices on April 12, at least until a new GM financing incentive program is put into place. Second, consumers appear to be less willing to trade in their old cars for new models. With 114.9 million registered passenger cars and 42.4 million registered vans and trucks on the highways, the demand for new automobiles may be small. At any rate, consumers are not purchasing automobiles and they have not yet shown any significant willingness to convert increased purchasing power into increased purchasing of other consumables. The one exception to this generally sluggish consumer performance is in the appliance and home improvement areas.

One area where some of the reduced investment activity has been partially offset is in housing. However, bad weather on the west coast and uncertainty about the impact of tax reform on the profitability of rental property has prevented single-family housing from exploding. Increasing housing activity is expected during the spring and into the early summer months. At that time, household borrowings for new mortgages may largely offset the diminished borrowing by energy distributors. In the meantime, interest rates will continue to trend downward.

Even the government sector is benefiting by the weakness in oil prices. Although the windfall profits taxed will generate very little revenue, falling oil prices substantially reduces the cost of procuring nondurables for the military and for the nonmilitary automobile fleets used by federal and state governments. While the oil patch states undoubtedly have severe fiscal year problems, some other states, especially along the eastern seaboard, may be pleasantly surprised by the budgetary windfalls that may materialize. As a result, government deficits probably will shrink slightly over the next six months.

The magnitude of the current oil generated sluggishness can be overstated. Although auto sales are weakening, auto production remains strong. As a result, inventories in the first quarter will add to GNP estimates. Production probably will weaken slightly in the second quarter and then diminish further in the summer months. Also, the trade deficit appears to have reached its maximum in December, although much of the trade deficit declines since that time appears to be related to falling oil prices in volumes. As the decline in oil import volu-

mes merely indicate a decline in energy material inventories, the impact upon domestic production is relatively modest. Nevertheless, net exports probably will not be detracting from GNP during the first quarter. As a result, economic activity is expected to expand by more than 4% in this quarter while the GNP deflator falls to a relatively low 1.8% rate of gain. In the second quarter, the GNP deflator is expected to show no increase at all. At that time, economic activity is expected to expand more than 4% after adjustment for inflation. While economic activity will be picking up in the second half of 1986, auto production will be trending downward. In addition, construction still is expected to reach a peak in the summer months and begin trending downward by the end of the year, even if falling interest rates will restrain the magnitude of construction weakness at that time.

Unfortunately, the plunge in interest rates that has excited bond and stock investors alike, appears to be related to a one-time shift in desired investment. Once the markets have adjusted to this change in investment desire resulting from oil nonprofitability, interest rates will again be trending upward. Although short-term interest rates almost certainly will decline further in the spring, and could even fall by a full percentage point from current levels, prospects of stable to rising short-term rates late in 1986 or early 1987, should prevent the rally in long-term bonds from going much beyond the current 7.50 yield on the long-term government bond. Indeed, the failure of other long-term instruments to rally as sharply as the government bond market suggests that special factors in that market, including the limitations upon issuing long-term government supply until the Senate raises the borrowing ceiling on such instruments, appears to be at work. Thus, investments appear to remain beneficial in corporate and tax-exempt issues but should not continue to generate significant capital gains opportunities in the long-term government bonds.

Also, the long-term government bonds have rallied so dramatically that stock prices have not been able to fully reflect the new, lower long-term interest rate environment. Equity values probably are 15% behind what would be justified by prevailing long-term government yields. Thus, further increases in stock market values still appear likely even though the market has moved upward by nearly 50% as measured by the Dow Jones index during the last year.

Quarterly Profile of GNP

	<u>1985-4</u>	<u>1986-1</u>	<u>1986-2</u>	<u>1986-3</u>	<u>1986-4</u>	<u>1987-1</u>	<u>1986</u> <u>Annual</u>
Real:	0.7	4.6	4.6	3.9	3.1	1.1	3.4
Price:	3.3	1.8	-0.0	2.8	3.5	3.9	2.2
Nominal:	4.0	6.6	4.6	6.7	6.6	5.2	5.6

Monthly Statistical Highlights for March 1986

Payroll employment +215,000; index of hours worked +0.2%; household employment +293,000; civilian unemployment rate 7.1%; personal income +0.6%; savings rate 5.2%; personal consumption +0.0%; retail sales -0.9%; auto sales 9.7 million; housing starts +1.9%; housing permits +2.8%; construction expenditures +2.1%; business inventories +0.7%; orders for durable goods +1.1%; orders for nondefense capital goods -2.3%; industrial production +0.4%; CPI -0.3%; PPI -0.0%; consumption deflator -0.2%; leading indicators +0.5%; real GNP +5.4%; M1 +10.1%; M2 +7.8%.

Monthly Statistical Highlights for April 1986

Payroll employment +253,000; index of hours worked +0.2%; household employment +330,000; civilian unemployment rate 7.0%; personal income +0.6%; savings rate 5.4%; personal consumption +0.5%; retail sales +0.3%; auto sales 9.8 million; housing starts +1.0%; housing permits +2.5%; construction expenditures +1.5%; business inventories +0.6%; orders for durable goods +0.8%; orders for nondefense capital goods +0.8%; industrial production +0.3%; CPI -0.1%; PPI -0.3%; consumption deflator UNC; leading indicators +0.5%; real GNP +5.4%; M1 +5.2%; M2 +6.2%.

COMMENTARY

Employment - Initial unemployment claims are currently showing a trendless pattern. Apparently, increases in unemployment associated with the oil industry weakness is being offset by increasing employment in manufacturing that previously had been exposed to import penetration. The 2.8% insured unemployment rate that has prevailed in March is equivalent to a 7.1% civilian unemployment rate. Therefore, a modest decline in the unemployment rate is anticipated despite a projected relatively large increase in household civilian employment. A large projected increase in employment is associated with the return of agricultural workers following the floods in the west.

Personal Income & Outlays - Excluding special factors that substantially restrain personal income in January, personal income in February would have increased 0.4%, about the same as January. However, gains in wages and salaries were more significant, although manufacturing payroll declined in February. In effect, the service economy spurred while the industrial economy stalled. This explains why our estimated GNP gains for February before inflation adjustment are as large as in January. This spurt in service activity should slow in March, but a rebound in manufacturing is anticipated at that time. While farm incomes are not expected to be helped by subsidy in March, as they were in February, personal income is expected to show a 0.6% March gain. Falling interest rates should once again begin restraining personal income gains during the second quarter, as interest income once again falls after only a short period of stabilization early in the year.

Auto sales were even more sluggish than originally anticipated in mid-March as domestic sales fell below 6.7 million units. Assuming import penetration of approximately 2.7 million, this means that auto sales in March will be below 10.0 million. Part of this weakness will be offset by significant further gain in hardware and appliances. In addition, sales at the grocery store and at restaurants are expected to intensify even as gasoline sales should continue to tumble. However, the price declines are so significant for energy products, that nondurables will show a further decrease before price adjustment. Service expenditures were significantly enhanced in February by a return to more normal utility usage following unusually mild temperatures in January and by a surge in financial services related to stock brokerage commissions. Commissions should remain strong in March but utilities should not show any significant spurt. As a result, consumption of services should grow at a much slower rate in March and April than in February.

Some analysts may be surprised by the continuing weakness in personal consumption expenditures and wonder where the consumer is. Clearly, the consumer

is waiting for renewed automobile incentives and will not be encouraged by GM's price strategies. However, prices are falling so significantly that estimates of no change in personal consumption expenditures should be converted into a moderate increase in real consumption after adjustment for inflation. Indeed, after inflation, consumer spending will be growing at a 2.8% annual rate during the first quarter.

Construction - Weather clearly reduced single-family activity during February. While some of the weakness was in the south and is related to the slump in employment activity in Texas, a significant amount of decline in single-family activity reflected unusual weather conditions out west. As weather improves, single-family starts should rise significantly through the spring. Rental units also are expected to continue growing robustly until May or June. Then, a construction pattern similar to that which greeted multiple units in 1985 is expected. Starts should fall sharply through the remainder of the year. Even so, housing starts now appear to be averaging 1.9 million for 1986. Orders for nonresidential construction rebounded significantly in February. While weather is expected to restrain nonresidential activity in that month, these increased orders suggests that activity will continue to grow into the fall. Activity then is expected to slow significantly late in the year. Orders were also up sharply for public construction projects. Here, however, concerns about tax exempt status and the impact of reduced revenue sharing and federal support for community development should restrain the growth in public construction. All construction is expected to begin trending downward toward the end of 1986, but the reduction in mortgage interest rates certainly increases the likelihood that construction spending will exceed forecasted amounts into 1987.

Business Activity - A surge in automobile inventories at wholesale and retail leads to surprisingly large \$4.1 billion increase in business inventories in January. Further sharp increases in business inventories are anticipated in February and March. While declining energy materials inventories will partially offset the impact from these growing business inventories, it now appears that inventories will contribute to GNP in the first quarter, after subtracting from GNP during the fourth quarter. While manufacturing inventories definitely are unusually lean, inventories at the retail and wholesale level appear to be adequate. They certainly are excessive in the automobile sector. Thus, the rebound from inventory rebuilding is expected to be less intense in the second and third quarters than originally projected.

Orders for nondefense capital equipment rebounded sharply above shipments in February as a result of significant orders for aircraft. Declining aircraft orders should be expected in March, but overall orders for nondefense capital goods are expected to remain above shipment into the fourth quarter. This suggests that the sluggishness that will appear in capital spending programs during the first quarter will be replaced by more substantial gains as the year progresses. The surprising dip in defense shipments is slowly dissipating, although defense orders showed a sharp fall in February following a surge in January.

The plunge in industrial production in February occurred despite an 8.7 million automobile assembly rate. This auto assembly rate almost certainly will trend downward to less than eight million by the summer months. However, business equipment activity should be rebounding while activity for defense and space also should begin increasing, following two months of surprising declines. Thus, industrial production is expected to rebound slightly in March and continue to grow through the remainder of the year. Even so, the rate of growth in

industrial activity will barely be sufficient to match the growth capacity. Therefore, capacity utilization is not expected to make any significant changes from current levels in 1986.

Prices - As mentioned in our last Projections, oil prices are dramatically reducing inflationary pressure for consumer nondurables and also should lower prices from previously forecasted value for consumer services. This is a surprising outlook, to the extent that some economists maintain that falling oil prices merely reflect changes in relative prices. Therefore, prices should be expected to rise for commodities other than oil. While some prices are rising, especially lumber products and prices of consumer durables, enough prices are falling to prevent inflationary pressures from intensifying until 1987.

Miscellaneous - Falling oil prices appear to have a greater impact upon the merchandise trade balance than originally expected. Although the deficit fell to \$12.49 billion in February as a result of 153 million barrels being imported at an average price of \$24.63, prices and volumes are expected to fall even further in March. By April, oil prices should not be a significant factor in causing further declines in the merchandise trade balance. However, the falling dollar should begin to exert downward pressures upon the trade deficit in the second half of 1986.

Leading indicators continues to be buoyed by declining prices, as the impact of falling prices upon the real money stock and indirectly upon equity values more than offsets its adverse effects upon sensitive prices. Moreover, the weakness in sensitive prices in February suggests that deflationary pressures will continue through the spring.

Sharp increases in unemployment and the plunge in industrial production suggests that GNP fell in February. However, the surge in services and the decline in the GNP deflator estimates for that month suggests that such a conclusion is incorrect. Indeed, personal income after adjustment for special factors grew at the same intensity in February as January while prices definitely fell in February after rising in January.

FINANCIAL MARKETS

As mentioned in the earlier commentary, a substantial shift in desired investment that has not been offset by a corresponding shift in desired savings appears to be responsible for this sharp decline in interest rates at the present time. The most intense downward pressures upon interest rates from these changed investment desires should occur in the spring. Therefore, short-term interest rates could fall by another full percentage point, although our projections only show a half percentage point decline. The long-term government bond appears to have overreacted to special conditions in the supply of long-term government instruments and is now yielding a value that can only be justified if a full percentage decline in short-term rates materialize and then is preserved. However, interest rates probably will begin trending slightly upward in the second half of 1986.

Although significant downward movement in long-term government bond yields from current levels is not anticipated, an enormous gap currently exists between the long-term government market and other long-term instruments. Fear that a toughened minimal tax will be exerted on tax-exempts, temporarily caused the

bond buyer to rise above .81 as a ratio of the Corporate AAAs. As most of the Senate does not wish to exert such burdens upon the tax-exempt market, values currently exist in the municipals market. Moreover, an enormous 140 basis point gap between the AAA and long-term government bonds suggest that significant value currently exists in the corporate market. Therefore, even if government interest rates show little further decline, significant gains still are anticipated in corporate markets. In addition, the BAA is expected to rally until its yield falls to approximately 9%. This means that the FHA mortgage rate also will approach 9%. All these interest yields are expected to materialize before the end of spring. After that time, interest rates are expected to be largely trendless, although the tax-exempt market may once again be hit with significant supply toward the end of 1986.

At the present time, the commercial paper rate has again begun to trade above the federal funds rate. This suggests a temporary increase in the demand for money leading to a significant expansion in the monetary base. However, commercial paper is expected to trend down below the federal funds rate in the spring, causing another decline in the discount rate. This will bring the prime rate down to 8.5% within the next month. A further decline to 8% cannot be totally ruled out, but interest rates then will be trending upward late in 1986 and early in 1987.

Equity Markets

Our current estimates show that nominal GNP will be rising about 5.6% in 1986. Because real economic activity is expected to accelerate slightly, the returns to capital should be growing slightly faster than that rate. Probably, returns to capital will be growing about 7%. However, falling interest rates mean that the returns to debt recipients will actually decline. As a result, the returns to equity owners will be growing about 12%. More significantly, the plunge in long-term interest rates indicates that the valuation of equity earnings will increase by more than one-third. This means that equity values could rise by 50% from 1985 levels. At the present time, the Dow Jones appears to remain almost 200 points below what these valuations justify. Of course, the stock market appears to be lagging behind the interest rate developments just as corporate AAA rates appear to be lagging behind long-term government bond yields. The markets are expected to catch up with interest rate conditions before the end of spring. By that time, the Dow Jones could exceed 2000, as multi-national corporations continue to be favored over domestic producers. Stock prices then are expected to show little change through the remainder of 1986 and may begin trending downward in 1987 if recessionary fears begin arising at that time.

EMPLOYMENT

	Payroll Employment		Index of Hours Worked		Household Civilian Employment		Civilian Unemployment Rate		Hourly Earnings Index	
	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.
October 1985	98559	98559	117.4	117.4	107813	107813	7.1	7.1	166.4	166.4
November	98739	98801	117.5	117.6	107969	107969	7.0	7.0	167.1	167.1
December	99059	99086	118.3	118.1	108206	108206	6.9	6.9	168.4	168.4
January 1986	99274	99507	118.6	119.3	108592	108955	6.8	6.7	169.2	167.5
February	99553	99733	119.0	118.9	108806	108561	6.9	7.3	170.0	168.5
March	99835	99948*	119.4	119.2*	109074	108854*	6.7	7.1*	170.9	169.1*
April	99986	100201	119.5	119.5	109265	109184	6.6	7.0	171.2	169.6
May	100184	100377	119.7	119.7	109532	109403	6.6	7.0	171.4	170.0
June	100380	100587	120.0	119.9	109799	109650	6.5	6.9	171.7	170.4
July	100617	100839	120.3	120.2	110013	109903	6.6	6.9	172.3	170.8
August	100872	101024	120.6	120.4	110184	110117	6.6	6.8	172.9	171.2
September	101127	101258	120.9	120.7	110329	110402	6.7	6.7	173.5	171.7
October	101256	101527	120.8	121.0	110483	110700	6.6	6.6	174.0	172.2
November	101403	101721	121.0	121.2	110729	110899	6.5	6.6	174.3	172.8
December	101382	101897	120.9	121.4	110843	111107	6.6	6.6	174.7	173.3
January 1987	101559	102015	121.2	121.5	111019	111251	6.5	6.7	175.6	173.9
February	101791	102200	121.5	121.7	111238	111476	6.5	6.7	176.5	174.5
March	102030	102310	121.8	121.8	111442	11606	6.5	6.7	177.3	175.1

PERSONAL INCOME

	Personal Income		Wage & Salary		Personal Savings		Disposable Income		Personal Outlays	
	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.
October 1985	3.331	3.331	1.991	1.992	127.8	120.0	2.825	2.826	2.698	2.706
November	3.347	3.348	2.003	2.004	120.3	120.4	2.838	2.840	2.717	2.719
December	3.394	3.384	2.025	2.022	106.1	105.3	2.879	2.872	2.773	2.767
January 1986	3.396	3.387	2.035	2.029	107.9	126.3	2.888	2.883	2.780	2.757
February	3.418	3.406	2.048	2.039	118.8	135.6	2.907	2.902	2.788	2.766
March	3.440	3.427*	2.062	2.052*	149.8	153.2*	2.926	2.920*	2.776	2.767*
April	3.455	3.448	2.071	2.065	144.3	158.1	2.937	2.938	2.793	2.780
May	3.471	3.463	2.079	2.073	134.7	153.4	2.949	2.949	2.815	2.796
June	3.487	3.480	2.088	2.083	122.7	147.1	2.962	2.962	2.839	2.815
July	3.505	3.499	2.100	2.094	118.5	147.1	2.973	2.977	2.855	2.830
August	3.522	3.517	2.112	2.104	123.1	146.0	2.985	2.991	2.862	2.845
September	3.539	3.536	2.125	2.116	117.8	114.0	2.997	3.006	2.879	2.862
October	3.558	3.557	2.132	2.129	120.7	146.2	3.011	3.023	2.890	2.877
November	3.578	3.576	2.139	2.141	118.8	144.4	3.027	3.037	2.908	2.893
December	3.599	3.595	2.146	2.151	114.0	146.8	3.044	3.051	2.930	2.904
January 1987	3.607	3.605	2.160	2.160	145.4	158.3	3.089	3.080	2.944	2.922
February	3.631	3.626	2.174	2.172	150.2	163.5	3.112	3.099	2.961	2.936
March	3.656	3.645	2.199	2.182	154.8	160.1	3.134	3.115	2.979	2.955

Fore. = February Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections

CONSUMPTION

	Personal Consumption		Durables		Nondurables		Services		Consumption Real	
	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.
October 1985	2603.1	2611.1	348.2	355.7	926.0	926.0	1328.9	1329.3	2301.6	2319.9
November	2621.7	2623.6	353.9	357.2	926.5	925.3	1341.3	1341.1	2303.8	2319.2
December	2675.1	2669.8	375.7	373.0	935.7	933.5	1363.7	1363.3	2342.5	2352.1
January 1986	2681.6	2658.9	380.5	368.8	939.6	931.4	1361.5	1358.7	2352.3	2336.3
February	2687.7	2667.3	378.2	367.9	941.3	924.4	1368.2	1375.0	2359.7	2349.2*
March	2673.7	2667.4*	357.9	360.7*	940.0	922.0*	1375.8	1384.7*	2345.4	2354.1
April	2689.5	2679.6	365.6	361.3	941.2	924.9	1382.7	1393.4	2351.0	2366.0
May	2709.8	2694.5	368.1	363.7	947.9	929.2	1393.8	1401.6	2358.4	2379.0
June	2733.0	2712.9	370.7	366.1	957.3	936.0	1405.0	1410.8	2370.3	2390.0
July	2746.7	2727.0	373.5	368.3	959.6	938.8	1413.6	1419.9	2376.0	2395.4
August	2752.6	2741.2	377.2	370.2	955.3	942.2	1420.1	1428.8	2375.0	2400.7
September	2768.7	2757.3	380.9	374.4	961.5	945.6	1426.3	1437.3	2382.7	2408.7
October	2778.3	2771.1	376.2	374.9	966.3	949.5	1435.8	1446.7	2380.7	2413.0
November	2794.5	2785.9	375.8	376.3	971.4	953.8	1447.3	1455.8	2386.4	2417.7
December	2815.0	2796.5	378.7	375.0	976.9	957.3	1459.4	1464.2	2395.7	2419.8
January 1987	2827.6	2813.1	380.6	377.6	980.8	961.7	1466.2	1473.8	2396.3	2425.2
February	2843.6	2826.0	382.8	378.8	984.0	965.9	1477.0	1481.3	2399.8	2428.0
March	2860.2	2844.5	385.1	381.6	987.3	971.8	1487.8	1491.1	2405.6	2433.9

RETAIL SALES

	Retail Sales		Non-Auto Durables		Auto (Million Units)		Nondurable Sales		Auto Sales	
	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.
October 1985	114.86	114.79	17.37	17.29	9.6	9.6	72.94	72.43	24.55	25.07
November	115.62	115.43	17.39	17.34	9.8	9.8	73.40	72.80	24.83	25.29
December	117.86	116.86	17.79	17.72	11.5	11.5	73.83	72.98	26.24	26.16
January 1986	119.05	116.98	18.02	17.91	11.5	11.5	74.20	72.70	26.83	26.37
February	118.51	116.81	18.22	17.17	11.0	10.6	74.33	72.55	25.96	26.09
March	116.62	115.79*	17.92	18.26*	9.3	9.7*	74.23	72.36*	24.47	25.13*
April	117.22	116.06	18.12	18.39	9.4	9.8	74.32	72.59	24.78	25.08
May	118.04	116.68	18.16	18.51	9.6	9.8	74.85	72.93	25.03	25.24
June	119.09	117.50	18.09	18.65	9.9	10.0	75.59	73.46	25.41	25.39
July	119.60	117.99	18.26	18.73	10.0	10.0	75.77	73.68	25.57	25.58
August	119.60	118.49	18.34	18.80	10.1	10.1	75.44	73.95	25.82	25.74
September	120.41	119.25	18.56	18.91	10.3	10.3	75.92	74.21	25.93	26.13
October	120.44	119.62	18.72	19.03	9.7	10.2	76.30	74.52	25.42	26.07
November	120.81	120.13	18.79	19.14	9.6	10.2	76.71	74.86	25.31	26.13
December	121.58	120.24	18.49	19.06	9.9	10.1	77.14	75.13	25.95	26.05
January 1987	122.11	120.91	18.52	19.19	10.0	10.2	77.45	75.48	26.14	26.24
February	122.62	121.38	18.61	19.27	10.1	10.1	77.70	75.81	26.31	26.30
March	123.15	122.18	18.69	19.37	10.2	10.2	77.96	76.27	26.50	26.54

Fore = February Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

CONSTRUCTION

	Housing Starts		Single Family Starts		Housing Permits		Construction Expenditures (Current)		Construction Expenditures (Real)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October 1985	1 772	1 784	1 120	1 118	1 688	1 688	346.3	346.1	204.8	204.7
November	1 566	1 654	0 961	1 006	1 661	1 661	348.1	345.1	206.2	204.3
December	1 840	1 804	1 113	1 087	1 844	1 873	349.4	354.0	206.9	209.6
January 1986	1 869	2 054	1 182	1 341	1 792	1 899	353.8	357.3	209.0	211.0
February	1 854	1 985	1 106	1 208	1 726	1 776	356.2	357.6*	210.1	210.6*
March	1 818	2 023*	1 111	1 248*	1 695	1 827*	359.1	365.2	211.7	214.3
April	1 808	2 044	1 107	1 273	1 652	1 873	360.0	370.7	211.8	216.9
May	1 801	2 041	1 103	1 289	1 629	1 906	360.2	371.6	211.1	216.9
June	1 796	1 990	1 099	1 254	1 634	1 883	361.4	374.2	211.2	217.9
July	1 743	1 954	1 076	1 241	1 596	1 806	363.9	375.5	212.1	218.2
August	1 718	1 914	1 082	1 217	1 543	1 725	366.2	375.4	212.9	217.6
September	1 701	1 871	1 085	1 203	1 542	1 738	368.4	375.0	213.7	216.9
October	1 673	1 832	1 093	1 168	1 492	1 694	368.4	374.9	212.9	216.2
November	1 691	1 803	1 109	1 173	1 491	1 673	368.5	374.4	212.0	215.2
December	1 668	1 763	1 122	1 159	1 490	1 621	368.8	374.9	211.3	214.7
January 1987	1 681	1 760	1 139	1 172	1 517	1 642	369.9	373.7	211.4	213.2
February	1 689	1 735	1 146	1 153	1 543	1 607	370.2	373.9	210.9	212.6
March	1 697	1 716	1 152	1 147	1 554	1 593	370.7	374.0	210.7	211.9

	Non Residential		Public Construction		Residential Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October 1985	132.1	132.2	62.6	62.8	150.6	151.1
November	133.4	132.8	64.5	62.5	150.3	149.7
December	134.3	138.9	65.1	64.5	150.0	150.6
January 1986	134.6	137.8	66.3	66.7	152.9	152.8
February	133.9	136.9*	67.4	66.2*	154.9	154.5*
March	133.9	137.4	68.2	66.5	157.0	161.3
April	134.7	138.0	68.3	66.9	157.0	165.8
May	135.6	138.5	68.0	67.2	156.6	165.9
June	136.4	138.9	67.7	67.5	157.3	167.8
July	136.3	139.4	68.7	67.8	158.9	168.3
August	136.8	140.0	69.4	68.1	160.0	167.3
September	137.2	140.4	70.0	68.5	161.2	166.1
October	138.1	140.8	69.5	68.9	160.8	165.2
November	139.0	141.0	69.0	69.2	160.5	164.2
December	139.9	141.1	68.4	69.3	160.5	164.5
January 1987	140.0	140.7	69.0	69.6	160.9	163.4
February	140.0	140.5	69.7	69.7	160.5	163.7
March	139.6	140.0	70.3	70.0	160.8	164.0

Fore. = February Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections

BUSINESS ACTIVITY

	Manufacturers Inventories		Durable Goods Orders		Non-Defense Capital Goods Orders		Non-Defense Capital Shipments	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October 1985	282.4	282.4	104.50	104.50	27.09	27.09	27.72	27.72
November	281.8	282.0	103.78	103.80	25.79	25.79	27.77	27.77
December	282.1	281.9	108.16	107.53	31.36	30.57	29.53	28.63
January 1986	282.9	280.7	106.19	108.46	28.42	24.55	29.03	25.60
February	283.7	280.0*	106.93	107.86	28.65	28.86	28.96	26.86
March	284.9	280.5	107.53	109.05*	29.13	28.21*	29.11	27.36*
April	286.2	281.6	107.27	109.92	29.10	28.43	29.15	27.73
May	287.3	283.0	106.78	110.86	28.66	28.76	29.07	28.14
June	288.3	284.2	107.08	111.24	28.93	28.93	29.08	28.37
July	289.5	285.1	107.46	111.21	29.17	29.16	29.12	28.68
August	290.8	286.3	108.13	112.16	29.25	29.34	29.15	28.93
September	292.0	287.5	107.92	111.28	29.02	29.28	29.14	29.14
October	293.5	288.9	107.43	110.93	28.86	29.35	29.12	29.33
November	295.4	290.3	107.16	110.48	28.72	29.22	29.18	29.36
December	297.4	291.6	106.92	109.62	28.78	29.07	29.23	29.42
January 1987	299.2	293.0	106.85	108.84	28.53	29.16	29.09	29.27
February	300.8	294.4	107.11	107.96	28.66	28.89	28.92	29.15
March	302.4	295.9	107.02	107.91	28.51	28.85	29.06	29.08

	Business Inventories		Defense Shipments		Industrial Production		Capacity Utilization	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October 1985	582.2	582.2	7.67	7.67	124.4	124.4	79.8	79.8
November	583.4	582.8	7.86	7.86	125.1	125.4	80.1	80.3
December	584.6	584.0	7.87	7.94	126.0	126.3	80.5	80.7
January 1986	585.1	588.1	7.95	7.03	126.8	126.5	80.8	80.6
February	587.6	591.4*	8.10	7.38	127.0	125.7	80.8	80.0
March	589.7	595.3	8.23	7.54*	127.2	126.2*	80.7	80.2*
April	591.4	598.9	8.30	7.63	127.5	126.6	80.7	80.3
May	594.5	601.7	8.33	7.79	127.8	127.0	80.7	80.4
June	597.4	604.1	8.37	7.85	128.1	127.3	80.7	80.5
July	599.1	606.2	8.46	7.93	128.2	127.6	80.6	80.5
August	601.5	609.5	8.57	8.09	128.3	128.0	80.4	80.6
September	603.8	612.4	8.69	8.12	128.5	128.3	80.3	80.6
October	606.4	615.1	8.65	8.20	128.7	128.6	80.2	80.6
November	610.7	620.2	8.60	8.27	128.8	128.9	80.0	80.6
December	615.5	623.3	8.61	8.33	128.7	129.1	79.7	80.5
January 1987	619.4	625.9	8.72	8.45	128.9	129.2	79.6	80.3
February	622.8	628.8	8.81	8.51	128.8	129.4	79.3	80.3
March	626.0	631.6	8.89	8.57	128.9	129.6	79.2	80.2

Fore. = February Forecast

C.E. = Current Expectations

* = This item and those beyond it are expectations.

PRICES

	CPI-U		PPI		PPI-Industrial		Estimated GNP	
	(seasonally adjusted)		Finished Goods (seasonally* adjusted)		Commodities (unadjusted)		Deflator	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October 1985	324.6	324.6	294.4	294.3	324.4	324.2	112.7	112.6
November	326.2	326.2	296.7	296.7	325.0	325.0	113.0	113.0
December	327.8	327.8	297.9	297.9	325.2	325.2	113.2	113.4
January 1986	328.7	328.7	297.3	296.2	323.9	324.0	113.6	113.7
February	328.6	327.4	296.9	291.8	322.5	319.4	113.9	113.5
March	329.1	326.4*	296.6	291.7*	321.2	316.9*	114.2	113.4
April	330.3	326.1	296.9	290.8	321.8	316.0	114.4	113.4
May	331.5	326.5	297.1	291.1	322.2	316.2	114.7	113.5
June	332.7	327.3	297.8	291.3	322.5	316.5	115.0	113.7
July	333.4	328.5	298.4	291.9	322.9	317.1	115.3	114.0
August	334.1	329.8	298.9	292.3	323.2	317.8	115.6	114.3
September	334.8	330.9	299.4	292.1	321.2	315.6	115.9	114.6
October	336.1	332.1	299.9	292.6	323.9	318.8	116.3	114.9
November	337.4	333.5	300.5	293.8	324.8	319.5	116.6	115.3
December	338.7	334.8	301.2	294.7	325.7	320.4	117.0	115.6
January 1987	340.2	335.9	302.0	295.6	326.5	321.2	117.4	116.0
February	341.7	337.0	302.9	296.5	327.0	322.1	117.9	116.4
March	343.3	338.4	303.8	297.6	327.6	332.9	118.3	116.9

	Consumption		Consumer		Consumer		Consumer		Implicit	
	Deflator		Durables		Nondurables		Services		Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October 1985	113.1	112.5	104.7	104.3	108.8	108.3	118.7	118.3	169.0	169.0
November	113.8	113.1	105.2	104.4	109.1	109.1	119.1	118.8	168.8	168.9
December	114.2	113.5	105.6	104.5	109.9	109.8	119.6	119.1	168.9	168.9
January 1986	114.0	113.8	105.0	105.0	109.8	109.8	119.9	119.5	169.3	169.3
February	113.9	113.5*	104.7	105.0*	109.5	108.5*	120.2	119.9*	169.5	169.8*
March	114.0	113.3	104.5	105.2	109.5	107.3	120.5	120.2	169.6	170.4
April	114.4	113.3	104.7	105.4	109.7	106.7	120.9	120.5	170.0	170.9
May	114.9	113.3	104.9	105.5	109.9	106.2	121.6	120.9	170.6	171.3
June	115.3	113.5	105.1	105.7	110.1	106.3	122.2	121.3	171.1	171.7
July	115.6	113.8	105.3	105.8	110.3	106.5	122.8	121.8	171.6	172.1
August	115.9	114.2	105.5	106.0	110.4	106.8	123.2	122.2	172.0	172.5
September	116.2	114.5	105.7	105.9	110.5	107.0	123.6	122.7	172.4	172.9
October	116.7	114.8	106.0	106.2	110.9	107.2	124.1	123.2	173.0	173.4
November	117.1	115.2	106.2	106.4	111.5	107.4	124.8	123.8	173.8	174.0
December	117.5	115.6	106.4	106.5	112.0	107.6	125.5	124.3	174.5	174.6
January 1987	118.0	116.0	106.5	106.7	112.3	107.9	126.0	124.9	175.0	175.3
February	118.5	116.4	106.7	107.0	112.5	108.2	126.5	125.4	175.5	175.9
March	118.9	116.9	106.9	107.3	112.7	108.6	127.1	126.0	175.9	176.5

Fore. = February Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections

MISCELLANEOUS

	Merchandise Trade Balance		Leading Indicators		Estimated GNP		Estimated GNP (1972 \$)		IVA (annual rate)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October 1985	-11.47	-14.01	171.3	171.6	4030	4028	3576	3577	-6.2	-6.2
November	-13.68	-12.81	171.5	172.0	4058	4050	3591	3584	-9.7	-10.2
December	-16.57	-14.91	173.6	174.2	4097	4095	3619	3611	-14.6	-13.6
January 1986	-14.93	-14.42	173.0	174.2	4133	4113	3638	3617	-0.6	-0.3
February	-14.21	-12.49	172.6	175.4*	4154	4121	3647	3631	4.3	9.6
March	-11.59	-11.63*	173.0	176.3	4176	4136	3657	3647	14.0	16.1
April	-13.29	-11.96	173.4	177.2	4198	4154	3670	3663	12.1	16.6
May	-13.85	-12.24	173.3	177.5	4215	4165	3675	3670	6.0	11.5
June	-13.26	-11.82	173.8	177.8	4233	4191	3681	3686	2.3	7.8
July	-13.46	-11.76	173.5	176.5	4254	4209	3690	3692	-1.0	7.1
August	-13.35	-11.53	173.2	176.4	4274	4244	3697	3713	-1.8	5.3
September	-13.23	-11.27	172.8	176.9	4295	4262	3706	3719	-1.9	4.1
October	-13.69	-11.43	172.9	176.5	4319	4287	3714	3731	-4.7	2.6
November	-13.49	-11.56	172.5	176.2	4346	4308	3727	3736	-9.3	0.9
December	-13.28	-11.21	172.8	176.7	4375	4325	3739	3741	-14.2	-1.1
January 1987	-13.07	-10.97	172.5	175.8	4396	4343	3744	3744	-12.6	-1.9
February	-12.98	-10.76	171.6	175.3	4414	4365	3744	3750	-10.7	-3.7
March	-12.88	-11.53	171.4	175.6	4433	4378	3747	3745	-8.9	-4.9

Fore. = February Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

FINANCIAL MARKETS

	Monetary Base		M1		M2		Federal Funds		T-Bills (6 Mos.)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October 1985	231.3	232.0	611.1	614.1	2532.8	2538.3	7.99	7.99	7.33	7.33
November	232.7	233.0	617.9	620.0	2546.8	2550.7	8.05	8.05	7.30	7.30
December	235.0	234.9	624.5	626.5	2563.1	2565.5	8.27	8.27	7.09	7.09
January 1986	236.5	235.6	627.3	627.1	2582.7	2568.4	8.06	8.14	7.10	7.16
February	237.0	238.1	629.2	630.9	2603.5	2576.2	7.96	7.86	7.08	7.11
March	237.6	239.2*	631.7	636.0*	2624.1	2592.3*	7.85	7.53*	7.06	6.73*
April	239.2	240.1	633.7	638.7	2636.7	2605.3	7.53	7.09	6.92	6.46
May	240.9	241.0	636.2	640.6	2648.5	2618.3	7.42	6.92	6.89	6.35
June	242.5	241.9	638.6	642.7	2660.5	2631.4	7.31	6.73	6.85	6.27
July	243.8	242.7	641.1	644.4	2681.4	2644.6	7.25	6.75	6.82	6.29
August	245.1	244.0	645.8	648.3	2698.7	2660.6	7.31	6.87	6.86	6.38
September	246.4	245.3	650.5	652.0	2716.0	2675.8	7.37	7.02	6.88	6.44
October	248.0	246.6	653.4	655.7	2734.3	2693.9	7.59	6.95	7.13	6.45
November	249.1	248.0	656.9	659.4	2754.9	2709.1	7.63	6.98	7.21	6.49
December	250.2	249.3	660.4	662.9	2775.4	2725.4	7.68	7.05	7.28	6.61
January 1987	251.8	250.5	663.9	666.3	2791.3	2744.5	7.85	7.11	7.40	6.67
February	253.1	251.6	667.4	669.3	2809.1	2759.9	7.93	7.06	7.46	6.65
March	254.4	253.0	671.1	672.7	2826.9	2776.5	7.82	7.10	7.40	6.69

	Aaa (Seasoned)		Municipals (Bond Buyer)		(3 Month) Commercial Paper		90 Day CD's		Prime Rate	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October 1985	11.02	11.02	9.08	9.08	7.80	7.80	7.88	7.88	9.50	9.50
November	10.55	10.55	8.54	8.54	7.77	7.77	7.81	7.81	9.50	9.50
December	10.16	10.16	8.43	8.43	7.75	7.75	7.80	7.80	9.50	9.50
January 1986	10.05	10.05	8.27	8.08	7.72	7.71	7.84	7.82	9.50	9.50
February	10.12	9.67	8.25	7.44*	7.63	7.63	7.75	7.69	9.50	9.50
March	10.08	9.08*	8.09	7.16*	7.56	7.42*	7.71	7.50*	9.50	9.32*
April	9.84	8.63	7.63	6.90	7.52	7.12	7.67	7.20	9.50	9.00
May	9.73	8.44	7.52	6.76	7.28	6.90	7.48	6.97	9.19	8.73
June	9.63	8.46	7.41	6.73	7.16	6.76	7.35	6.85	9.00	8.50
July	9.44	8.51	7.26	6.77	7.11	6.85	7.29	6.93	9.00	8.50
August	9.49	8.53	7.28	6.81	7.26	6.94	7.42	7.05	9.00	8.50
September	9.53	8.50	7.35	6.80	7.42	7.05	7.63	7.16	9.00	8.50
October	9.55	8.59	7.36	6.87	7.65	7.08	7.78	7.20	9.00	8.50
November	9.58	8.64	7.40	6.95	7.72	7.11	7.95	7.21	9.00	8.50
December	9.61	8.61	7.44	7.13	7.79	7.23	8.14	7.32	9.00	8.76
January 1987	9.88	8.65	7.63	7.08	7.93	7.29	8.23	7.38	9.08	9.00
February	9.95	8.73	7.74	6.98	7.99	7.21	8.30	7.35	9.50	9.00
March	9.96	8.75	7.77	7.01	7.95	7.18	8.27	7.31	9.50	9.00

Fore. = February Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections

4-1-87

Georgia State University

a unit of the university system of georgia

4/29/86 G86 - U1P80-3
university plaza
atlanta, georgia 30303-3083

college of business administration
economic forecasting center
404 658-3282

MONTHLY PROJECTIONS April 1986

Dr. Donald Ratajczak, Director
For Release: April 24, 1986

DEFLATION SHOULD VANISH WITH MAY FLOWERS

Plunging oil prices have left their mark upon the monthly price indices. The Producers Price Index has fallen sharply in January, February, and March and is expected to fall significantly again in April. The Consumer Price Index has fallen by 0.4% in February and March and should decline by a similar amount in April. Falling consumer prices are also possible in May. However, crude petroleum prices have stabilized at slightly over \$13 per barrel for Louisiana crude. This means that other oil prices also will be stabilizing shortly.

Excluding oil, the inflation outlook has been mixed. A plunging dollar has increased inflationary pressures for some metals and for pharmaceuticals as drug companies shift their sales efforts to Europe. Sharply rising insurance rates have left their mark on medical fees, auto insurance, and general business costs. The sharp decline in mortgage rates has strengthened housing prices and also generated some increasing inflationary pressures for lumber products. Thus, inflation excluding the impact of oil prices has been sustained at a 3.5-4% range.

To be sure, the plunge in oil prices should continue to have some deflationary impact upon other sectors for some time to come. Falling oil prices directly lead to falling chemical feedstocks and to the major material used in plastics. In addition, energy is a heavy cost factor in transportation services, most metal production, and most nonmetallic minerals. Some price weakness has begun to surface in the plastics and chemicals, but more significant price declines still should be anticipated.

Moreover, falling inflationary pressures should lead to more moderate wage gains than originally projected. Wages should be growing only 4% in the next year. If the economy begins experiencing more industrial growth, productivity should begin rising in the second half of 1986. Therefore, unit labor cost should be rising only about 2.5% even in the latter part of this year. Even so, it appears that inflation will be returning to 4% before the end of the year and probably will be growing slightly in excess of that in 1987.

Clearly, yields on long-term government bonds are too low if inflation is to rebound to 4% following the plunge in oil prices. Yields between 7.5% and 8% appear to be justified by the inflationary environment. One of the puzzling results of plunging oil prices is the magnitude by which this temporary restraint on inflation has impacted yields on long-term interest rates relative to short-term rates. According to some economic theories, short-term changes in inflationary conditions should be reflected most dramatically in short-term yields. Yet, long-term government bond yields have decreased by nearly three percentage points while short-term rates have fallen by less than one percentage point over the past six months. Inflationary anticipations may have diminished dramatically, but, more likely, speculators have been following the downward trend of long-term government bonds and have bid the value of those bonds beyond what is justified by economic conditions. This may explain why unusually large spreads have developed between long-term government bonds and yields on other long-term government instruments. For example, the corporate AAA bond is currently yielding nearly 1.5 percentage points more than the long-term government instrument. Historically, a 0.4 percentage point gap between the two yields is normal. Indeed, if other long-term instruments maintain their current yields, the long-term government bond would need to re-establish yields of nearly 8% before traditional spreads reappear.

In the past few weeks interest rate weakness has developed for short-term instruments. The commercial paper rate fell dramatically below rates for federal funds and even below yields on certificates of deposit. The weakness in commercial paper appears to be directly related to the reduced need to use paper to finance oil inventories. This weakness in borrowing needs was anticipated in our previous report. This plunge in borrowing needs should subside now that crude oil prices appear to be stabilizing. Thus, downward pressures upon short-term interest rates should begin dissipating toward the end of May.

Preliminary estimates of GNP for the first quarter were more sluggish than expected as a result of downward revisions in inventory holdings. Also, the estimated GNP deflator was stronger than expected, although the preliminary GNP estimates may overstate prices in the consumer sector for March. Thus, a downward adjustment in the deflator should more than offset any downward adjustment in trade balances that may materialize. However, plunging oil prices corresponded with plunging oil imports during the first quarter. Therefore, the trade balances estimated by the Department of Commerce may be close to actual outcomes.

Economic activity was still surprisingly weak in March, but inventory rebuilding is expected to resume in non-auto manufacturing during the second quarter. This inventory gain should be more than sufficient to offset moderate inventory liquidations in the automobile sector. At the same time, fixed investment should increase significantly following a decline in the winter months. Apparently, some investors accelerated shipments of investment goods into the fourth quarter of 1985 to ensure the tax deductibility for investment tax credits. This left a period of weak shipments early in 1986 that are now coming to an end.

As expected, inventory profits vanished in the first quarter. Following a \$10.6 billion increase in inventory profits during the fourth quarter, prices of inventories generated inventory losses of \$13.8 billion in the first three months of 1986. This will cause after-tax corporate profits to fall more than 6% in the first quarter. However, operating profits should increase by more

than 10% at annual rates. This significant increase in operating profits along with already registered declines in interest rates, suggests that stock market values can continue to rise through the second quarter. However, the outlook for rising inflationary pressures, upward pressures upon interest rates, and little further growth in operating profits after the summer months all suggest that stock prices will be trending downward during the second half of 1986.

Quarterly Profile of GNP

	<u>1985-4</u>	<u>1986-1</u>	<u>1986-2</u>	<u>1986-3</u>	<u>1986-4</u>	<u>1987-1</u>	<u>1986 Annual</u>
Real:	0.7	3.2	4.2	4.7	2.1	2.6	2.9
Price:	3.3	2.5	-0.4	3.2	3.5	4.1	2.4
Nominal:	4.3	5.8	3.7	8.0	5.7	6.9	5.3

Monthly Statistical Highlights for April 1986

Payroll employment +188,000; index of hours worked +0.2%; household employment +236,000; civilian unemployment rate 7.2%; personal income +0.5%; savings rate 4.4%; personal consumption +0.4%; retail sales +0.1%; auto sales 9.8 million; housing starts +2.9%; housing permits +0.6%; construction expenditures +0.9%; business inventories +0.1%; orders for durable goods -0.6%; orders for nondefense capital goods +5.6%; industrial production +0.2%; CPI -0.4%; PPI -0.3%; consumption deflator -0.1%; leading indicators +0.3%; real GNP +3.7%; M1 +8.6%; M2 +7.2%.

Monthly Statistical Highlights for May 1986

Payroll employment +238,000; index of hours worked +0.2%; household employment +256,000; civilian unemployment rate 7.1%; personal income +0.5%; savings rate 4.3%; personal consumption +0.6%; retail sales +0.5%; auto sales 10.0 million; housing starts -0.3%; housing permits -1.7%; construction expenditures 0.0%; business inventories +0.1%; orders for durable goods +0.5%; orders for nondefense capital goods -1.0%; industrial production +0.3%; CPI +0.2%; PPI +0.2%; consumption deflator +0.2%; leading indicators +0.2%; real GNP 3.0%; M1 +4.2%; M2 +6.2%.

COMMENTARY

Employment - For the second consecutive quarter, the index of hours worked grew at a faster rate than estimated GNP. This means that productivity fell slightly in the winter following a significant decline in the fall. Some of the problems associated with productivity appear to be related to more rapid expansion in retail space and employment than in retail sales volumes. In addition, shifts in composition away from high productivity industries to lower productivity industries has created some of this discrepancy between output and labor input.

Payroll employment increased less than anticipated in March as a result of a greater impact from plunging oil exploration than had been anticipated. In addition, automobile production began declining in order to reduce inventories to levels that are considered desirable within the industry. Initial

unemployment claims have increased slightly as a result of weakness in the southwest and the unemployment rate for insured personnel increased to 2.9%. This is consistent with the 7.2% unemployment rate that prevailed in March. The hourly earnings index remains moderate, showing increases of only 2.9% from the previous year. In the past six months, there has been no acceleration in earnings per hour worked.

Personal Income & Outlays - An upward revision in the nondurable component of retail sales led to an upward revision in consumption outlays. This was a major revision that did not alter the quarter-by-quarter growth rate but significantly increased overall consumption relative to income. As a result, nearly a percentage point was reduced from the prevailing savings rate.

As expected, the apparent sluggishness in personal consumption expenditures is largely the result of declining prices. Indeed, this surge in nondurable spending in March as a result of strong department store and apparel sales was especially robust once declining gasoline prices are also considered. Claims that the consumer has not yet begun to support this economy are clearly exaggerated. Our estimates for March suggest that consumption after price adjustments has increased nearly \$35 billion within the quarter. Strong consumer gains almost certainly will persist in the second quarter. This is especially likely as automobile dealer incentives have reappeared and auto sales activity has begun to increase.

The booming stock market has created some upward biases in service expenditures as a result of a surge in commission payments. Therefore, the service sector will not be able to sustain the rapid first quarter rates of growth later in the year. By that time, however, improving auto sales will aid purchases of durable goods. Consumer spending after adjustment for price changes probably will grow nearly 4% in 1986.

As gasoline prices will continue to fall in April, and as the vigorous growth in apparel sales probably will slow in that month, retail sales should continue to show a sluggish pattern before inflation adjustment. However, price adjustments suggest that consumer expenditures will be growing at a real annual rate of nearly 7% in April. This certainly is vigorous consumer growth that will be totally misinterpreted when a nearly unchanged retail sales figure is announced for the month.

Early in the quarter, disposable income showed a rapid rate of growth because the indexation of tax codes was included in the January tax liability estimates. This indicated a sharp decrease in tax liability in January. Significant declines in tax liabilities are not anticipated for the remainder of the year. Personal in March was significantly reduced by a sharp decline in farm subsidies. Such subsidy declines are not expected to continue in the remainder of this year. However, a falloff in interest income should continue through the spring. Thus, personal income probably will be growing more slowly than wage income until the second half of 1986.

Construction - The weakness in the southwest will have a more substantial adverse effect upon housing than originally anticipated. Nevertheless, declining mortgage rates should generate slightly more than 1.2 million single-family starts in 1986. Both the absence of further mortgage rate declines late in the year and the absence of any pent-up demand should cause starts to fade into 1987. Multi-family starts are showing a pattern similar to 1985. Permits

and activity are especially vigorous early in the year hoping that buildings can be placed on the tax rolls before adverse tax changes materialize. Later in the year, starts are expected to decline sharply. Estimates of permit activity should reflect this pattern. The surge in residential activity early this year will lead to sharp gains in expenditures for residential construction through July. In addition, increased housing demand is leading to increased lumber prices that will add to construction costs. Later in the year, however, orders for nonresidential construction activity should diminish. Toward the end of the year, overall expenditures should plateau. As a result, construction should decline moderately by the end of 1986.

Business Activity - Orders for commercial aircraft are substantially distorting the pattern of orders for nondefense capital goods. In March, the absence of large commercial orders caused a significant decline in that measure. In April, commercial aircraft should reappear. Then another decline is expected in May. However, the trend for nondefense capital goods orders should be upward. This should lead to a significant increase in shipments following the tax distorted slump in shipments in the first two months of 1986. Fixed investment, therefore, will perform more strongly in the middle quarters of 1986 than early in the year.

Defense orders also are jumping wildly. Some defense shipments should rebound now that order backlogs are increasing. Nevertheless, shipments have lagged sufficiently far behind previous anticipations that they will not be able to reach forecasted values in the next 12 months.

Sharply declining prices for petroleum products are being reflected in business inventories and sales reports. Until those prices stabilize, the dollar value of business inventories should show little change. By June, however, inventories are expected to re-accelerate.

Weakness in industrial production is heavily concentrated in mining and in automobile assemblies in March. Now that automobiles are being assembled domestically at a 7.7 million rate and sales have begun drifting toward that rate, only moderate further weakness in production of consumer goods is anticipated in the next few months. Business equipment should increase significantly while materials production also should rise. Therefore, the lag in industrial production behind forecasted values, which materialized early in 1986, should disappear by the end of the year.

Prices - Now that crude petroleum prices appear to have stabilized, declines in product prices for petroleum should soon stabilize as well. Deflation probably will come to an end with one last big plunge in the April CPI. However, a modest price decline in May also is likely. At the same time, the administration's proposal for slaughtering dairy cattle has created weakness in the meat sector as livestock raisers hustle to sell their animals prior to their dairy slaughter glut. This will generate lower meat prices than had previously been anticipated. As a result, prices during the summer are not expected to rebound as sharply as originally feared. Nevertheless, inflation will reappear in excess of 3% during the second half of 1986. By 1987, the inflation rate should exceed 4%.

Miscellaneous - Leading indicators generally benefit from rising stock prices and rising real money balances from a plunging CPI. Once interest rates stabilize, these financial variables no longer are expected to propel the leading

indicators upward. Current estimates, which are based upon slightly declining stock prices in the second half of 1986, declining building permits, little change in initial unemployment claims, and only small increases in real money balances, leads to relatively trendless patterns after the spring.

Because of the plunge in oil prices, the IVA has reversed dramatically from a significant inventory profit late in 1985 to a large inventory loss in March. This swing of almost \$42 billion also reflects the swing in commercial paper financing necessary to support an unchanged volume of inventories. Short-term interest rate pressures were diminishing at their maximum rate late in the first quarter. They still are diminishing, but the rate of decline has slowed substantially. Therefore, short-term interest rates may begin pressing upward before the end of spring.

Finally, the merchandise trade balances have been adjusted to remove seasonal influence and to capture adjustments reported in terms of processing delays. The downward trend in the trade deficit is the result of reduced oil prices rather than any significant influence at the present time from declining values of the dollar. As the dollar has continued to diminish in value, foreign exchange-related changes in trade flows should begin materializing in the latter part of 1986.

FINANCIAL MARKETS

Virtually all our indicators of interest rate movements suggest that rates should be falling into the spring months. Corporate borrowings are falling significantly as a result of reduced inventory financing needs, investment activity remains subdued, housing activity has increased but not sufficiently to offset diminished borrowings from the corporate sector, while government is showing little change in its borrowing needs. However, economic activity is expected to increase late in the spring along with prices. As prices rise, more financing will be needed to support inventories. Therefore, interest rates should begin trending upward in the summer months.

Our current estimates suggest that interest rates could fall further as Secretary Baker tries one more time to establish coordinated declines in interest rates by all major industrial powers. However, domestic interest rate pressures should surface even before the spring is over. For that reason, investments in long-term government bonds probably have no capital gains potential at the present time. While capital gains potential also is relatively modest for the corporate and tax exempt markets, investments there still may be justified because of the wide yield differentials that exist between those instruments and the government securities.

Although these projections suggest that another decline in the discount rate along with another cut in the prime rate may materialize by June, any further benefits from declining short-term interest rates are expected to vanish late in the year. Because of this abrupt anticipated turnaround in short-term rates, that last decline in the prime rate may never materialize.

Equity Markets

The first quarter GNP estimates showed slightly less nominal GNP growth than anticipated, but not enough to significantly alter our estimates of operating profits after tax liabilities for 1986. These profits are expected to rise about 12%. Interest rates in 1986 as measured by the corporate AAA should be about 35% less than in 1985. Equity values should rise in excess of 45% from 1985 levels. This suggests that the Dow Jones could exceed 2000, but most of this improvement should materialize by the end of the spring. In the second half of 1986, interest rates may be trending upward. In addition, economic growth may slow. As a result, operating profits less tax liabilities in 1987 may show minimal growth. Thus, the stock market will have to decide whether economic conditions in 1987 warrant further advances. If our above analysis is correct, stock market values should average slightly lower in 1987 than in 1986. Therefore, a decline in the stock market could begin before the end of summer and persist until any recessionary fears concerning 1987 have either dissipated or been realized.

EMPLOYMENT

	Payroll Employment		Index of Hours Worked		Household Civilian Employment		Civilian Unemployment Rate		Hourly Earnings Index	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October 1985	98559	98559	117.4	117.4	107813	107813	7.1	7.1	166.4	166.4
November	98739	98801	117.5	117.6	107969	107969	7.0	7.0	167.1	167.1
December	99059	99086	118.3	118.1	108206	108206	6.9	6.9	168.4	168.4
January 1986	99274	99496	118.6	119.1	108592	108955	6.8	6.7	169.2	167.4
February	99553	99649	119.0	118.5	108806	108561	6.9	7.3	170.0	168.4
March	99835	99841	119.4	118.9	109074	108788	6.7	7.2	170.9	168.8
April	99986	100029*	119.5	119.2*	109265	109024*	6.6	7.2*	171.2	169.2*
May	100184	100267	119.7	119.5	109532	109280	6.6	7.1	171.4	169.5
June	100380	100584	120.0	119.8	109799	109568	6.5	7.0	171.7	169.8
July	100617	100851	120.3	120.2	110013	109820	6.6	6.9	172.3	170.2
August	100872	101093	120.6	120.5	110184	110106	6.6	6.9	172.9	170.6
September	101127	101343	120.9	120.7	110329	110387	6.7	6.9	173.5	171.1
October	101256	101611	120.8	121.0	110483	110689	6.6	6.8	174.0	171.6
November	101403	101777	121.0	121.2	110729	110919	6.5	6.8	174.3	172.2
December	101382	101961	120.9	121.4	110843	111122	6.6	6.8	174.7	172.7
January 1987	101559	102153	121.2	121.6	111019	111337	6.5	6.8	175.6	173.3
February	101791	102320	121.5	121.7	111238	111522	6.5	6.8	176.5	173.9
March	102030	102411	121.8	121.8	111442	111642	6.5	6.9	177.3	174.6

PERSONAL INCOME

	Personal Income		Wage & Salary		Personal Savings		Disposable Income		Personal Outlays	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October 1985	3.331	3.331	1.991	1.992	127.8	120.0	2.825	2.826	2.698	2.706
November	3.347	3.348	2.003	2.004	120.3	120.4	2.838	2.840	2.717	2.719
December	3.394	3.384	2.025	2.022	106.1	105.3	2.879	2.872	2.773	2.767
January 1986	3.396	3.387	2.035	2.027	107.9	124.7	2.888	2.882	2.780	2.758
February	3.418	3.401	2.048	2.034	118.8	125.7	2.907	2.896	2.788	2.771
March	3.440	3.407	2.062	2.044	149.8	122.9	2.926	2.904	2.776	2.781
April	3.455	3.424*	2.071	2.056*	144.3	127.0*	2.937	2.919*	2.793	2.792*
May	3.471	3.442	2.079	2.066	134.7	126.2	2.949	2.935	2.815	2.808
June	3.487	3.459	2.088	2.077	122.7	124.6	2.962	2.949	2.839	2.824
July	3.505	3.473	2.100	2.090	118.5	120.6	2.973	2.959	2.855	2.838
August	3.522	3.494	2.112	2.102	123.1	123.9	2.985	2.976	2.862	2.852
September	3.539	3.515	2.125	2.113	117.8	124.1	2.997	2.993	2.879	2.869
October	3.558	3.536	2.132	2.126	120.7	128.7	3.011	3.010	2.890	2.881
November	3.578	3.556	2.139	2.138	118.8	127.9	3.027	3.026	2.908	2.898
December	3.599	3.575	2.146	2.150	114.0	123.5	3.044	3.040	2.930	2.917
January 1987	3.607	3.586	2.160	2.162	145.4	129.5	3.089	3.061	2.944	2.932
February	3.631	3.604	2.174	2.173	150.2	129.8	3.112	3.078	2.961	2.948
March	3.656	3.623	2.199	2.185	154.8	132.0	3.134	3.095	2.979	2.963

C.E. = Current Expectations

* = This item and those beyond it are projections.

CONSUMPTION

	Personal Consumption		Durables		Nondurables		Services		Consumption Real	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October 1985	2603.1	2611.1	348.2	355.7	926.0	926.0	1328.9	1329.3	2301.6	2319.9
November	2621.7	2623.6	353.9	357.2	926.5	925.3	1341.3	1341.1	2303.8	2319.2
December	2675.1	2669.8	375.7	373.0	935.7	933.5	1363.7	1363.3	2342.5	2352.1
January 1986	2681.6	2659.6	380.5	368.8	939.6	933.9	1361.5	1356.9	2352.3	2337.3
February	2687.7	2671.5	378.2	364.0	941.3	935.0	1368.2	1372.5	2359.7	2357.5
March	2673.7	2680.8	357.9	354.4	940.0	948.6	1375.8	1377.8	2345.4	2374.4*
April	2689.5	2691.2*	365.6	357.0*	941.2	947.5*	1382.7	1386.7*	2351.0	2387.7
May	2709.8	2706.6	368.1	359.4	947.9	951.9	1393.8	1395.3	2358.4	2394.2
June	2733.0	2721.8	370.7	361.4	957.3	956.8	1405.0	1403.6	2370.3	2401.5
July	2746.7	2734.9	373.5	361.0	959.6	961.6	1413.6	1412.3	2376.0	2406.6
August	2752.6	2747.7	377.2	360.4	955.3	965.9	1420.1	1421.4	2375.0	2409.9
September	2768.7	2763.6	380.9	363.7	961.5	969.6	1426.3	1430.3	2382.7	2417.3
October	2778.3	2775.0	376.2	362.9	966.3	972.6	1435.8	1439.5	2380.7	2419.5
November	2794.5	2790.2	375.8	364.7	971.4	976.8	1447.3	1448.7	2386.4	2424.7
December	2815.0	2808.0	378.7	368.1	976.9	982.4	1459.4	1457.5	2395.7	2431.3
January 1987	2827.6	2822.1	380.6	369.5	980.8	985.9	1466.2	1466.7	2396.3	2434.4
February	2843.8	2837.9	382.8	370.3	984.0	991.3	1477.0	1476.3	2399.8	2438.8
March	2860.2	2851.8	385.1	371.1	987.3	994.8	1487.8	1485.9	2405.6	2441.3

RETAIL SALES

	Retail Sales		Non-Auto Durables		Auto (Million Units)		Nondurable Sales		Auto Sales	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October 1985	114.86	114.79	17.37	17.29	9.6	9.6	72.94	72.43	24.55	25.07
November	115.62	115.43	17.39	17.34	9.8	9.8	73.40	72.80	24.83	25.29
December	117.86	116.86	17.79	17.72	11.5	11.5	73.83	72.98	26.24	26.16
January 1986	119.05	117.35	18.02	17.86	11.5	11.5	74.20	73.16	26.83	26.33
February	118.51	117.45	18.22	17.97	11.0	10.6	74.33	73.57	25.96	25.91
March	116.62	116.56	17.92	18.07	9.3	9.7	74.23	73.46	24.47	25.02
April	117.22	116.62*	18.12	18.20*	9.4	9.8*	74.32	73.22*	24.78	25.20*
May	118.04	117.26	18.16	18.26	9.6	10.0	74.85	73.56	25.03	25.44
June	119.09	117.88	18.09	18.41	9.9	10.0	75.59	73.94	25.41	25.53
July	119.60	118.20	18.26	18.53	10.0	9.9	75.77	74.31	25.57	25.36
August	119.60	118.46	18.34	18.64	10.3	9.8	75.44	74.64	25.82	25.18
September	120.41	119.30	18.56	18.71	10.3	10.2	75.92	75.08	25.93	25.51
October	120.44	119.43	18.72	18.79	9.7	9.8	76.30	75.31	25.42	25.33
November	120.81	119.98	18.79	18.86	9.6	9.9	76.71	75.64	25.31	25.48
December	121.58	120.83	18.49	19.03	9.9	10.1	77.14	76.07	25.95	25.73
January 1987	122.11	121.27	18.52	19.15	10.0	10.1	77.45	76.34	26.14	25.78
February	122.62	121.78	18.61	19.17	10.1	10.0	77.70	76.76	26.31	25.85
March	123.15	122.15	18.69	19.25	10.2	10.0	77.96	77.03	26.50	25.87

Fore. = February Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

CONSTRUCTION

	Housing Starts		Single Family Starts		Housing Permits		Construction Expenditures (Current)		Construction Expenditures (Real)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October 1985	1.772	1.784	1.120	1.118	1.688	1.688	346.3	344.5	204.8	202.2
November	1.566	1.654	0.961	1.006	1.661	1.661	348.1	343.8	206.2	200.9
December	1.840	1.804	1.113	1.087	1.844	1.873	349.4	351.7	206.9	205.0
January 1986	1.869	2.034	1.182	1.335	1.792	1.899	353.8	356.1	209.0	206.9
February	1.854	1.997	1.106	1.204	1.726	1.803	356.2	360.5	210.1	209.2
March	1.838	1.949	1.111	1.212	1.695	1.846	359.1	367.2*	211.7	212.5*
April	1.808	2.006*	1.107	1.242*	1.652	1.857*	360.0	370.5	211.8	213.9
May	1.801	1.999	1.103	1.256	1.629	1.826	360.2	370.5	211.1	213.3
June	1.796	1.969	1.099	1.243	1.634	1.803	361.4	372.0	211.2	213.5
July	1.743	1.932	1.076	1.221	1.596	1.765	363.9	374.4	212.1	214.3
August	1.718	1.876	1.082	1.208	1.543	1.742	366.2	373.6	212.9	213.4
September	1.701	1.874	1.085	1.211	1.542	1.728	368.4	372.2	213.7	212.2
October	1.673	1.841	1.093	1.193	1.492	1.711	368.4	372.7	212.9	211.8
November	1.651	1.807	1.109	1.169	1.491	1.652	368.5	372.5	212.0	211.0
December	1.668	1.779	1.122	1.162	1.490	1.609	368.8	371.5	211.3	209.9
January 1987	1.681	1.763	1.139	1.143	1.517	1.613	369.9	370.7	211.4	208.8
February	1.689	1.754	1.146	1.152	1.543	1.619	370.2	369.0	210.9	207.3
March	1.697	1.747	1.152	1.159	1.554	1.605	370.7	371.7	210.7	208.2

	Non-Residential		Public Construction		Residential Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October 1985	132.1	131.2	63.6	62.4	150.6	150.9
November	133.4	131.6	64.5	62.6	150.3	149.7
December	134.3	136.2	65.1	64.8	150.0	150.7
January 1986	134.6	135.4	66.3	68.1	152.9	152.6
February	133.9	137.8	67.4	66.9	154.9	155.8
March	133.9	138.6*	68.2	67.3*	157.0	161.3*
April	134.7	139.2	68.3	67.7	157.0	163.6
May	135.6	140.3	68.0	67.9	156.6	162.3
June	136.4	140.8	67.7	68.4	157.3	162.8
July	136.3	141.3	68.7	68.7	158.9	164.4
August	136.8	141.9	69.4	68.5	160.0	163.2
September	137.2	142.2	70.0	68.9	161.2	161.1
October	138.1	142.5	69.5	69.2	160.8	161.0
November	139.0	142.1	69.0	69.5	160.5	160.9
December	139.9	140.9	68.4	69.8	160.5	160.8
January 1987	140.0	140.8	69.0	70.0	160.9	159.9
February	140.0	140.3	69.7	70.3	160.5	158.4
March	139.6	140.5	70.3	70.5	160.8	160.7

Fore. = February Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

BUSINESS ACTIVITY

	Manufacturers' Inventories		Durable Goods Orders		Non-Defense Capital Goods Orders		Non-Defense Capital Shipments	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October 1985	282.4	282.4	104.50	104.50	27.09	27.09	27.72	27.72
November	281.8	282.0	103.78	103.80	25.79	25.79	27.77	27.77
December	282.1	281.9	108.16	107.53	31.36	30.57	29.53	28.63
January 1986	282.9	280.4	106.19	108.46	28.42	24.55	29.03	25.60
February	283.7	279.5	106.93	107.82	28.65	28.91	28.96	26.86
March	284.9	278.7*	107.53	105.07	29.13	27.02	29.11	27.82
April	286.2	279.0	107.27	104.42*	29.10	28.53*	29.15	27.75*
May	287.3	279.9	106.78	104.96	28.66	28.24	29.07	28.13
June	288.3	281.5	107.08	104.78	28.93	28.52	29.08	28.42
July	289.5	282.3	107.46	106.23	29.17	28.89	29.12	28.69
August	290.8	283.1	108.13	107.15	29.25	29.43	29.15	28.84
September	292.0	284.4	107.92	107.64	29.02	29.46	29.14	29.07
October	293.5	285.8	107.43	107.26	28.86	29.35	29.12	29.15
November	295.4	286.7	107.16	107.19	28.72	29.16	29.18	29.21
December	297.4	288.1	106.92	108.13	28.78	29.20	29.23	29.28
January 1987	299.2	288.7	106.85	108.44	28.53	29.35	29.09	29.46
February	300.8	290.5	107.11	107.53	28.66	28.89	28.92	29.43
March	302.4	291.3	107.02	107.26	28.51	28.74	29.06	29.36

	Business Inventories		Defense Shipments		Industrial Production		Capacity Utilization	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October 1985	582.2	582.2	7.67	7.67	124.4	124.4	79.8	79.8
November	583.4	582.8	7.86	7.86	125.1	125.4	80.1	80.3
December	584.6	583.2	7.87	7.94	126.0	126.4	80.5	80.7
January 1986	585.1	585.0	7.95	7.03	126.8	126.6	80.8	80.7
February	587.6	585.1	8.10	7.58	127.0	125.7	80.8	80.0
March	589.7	586.4*	8.23	7.27	127.2	125.1	80.7	79.4
April	591.4	586.7	8.30	7.48*	127.5	125.4*	80.7	79.5*
May	594.5	587.4	8.33	7.63	127.8	125.9	80.7	79.6
June	597.4	590.2	8.37	7.74	128.1	126.5	80.7	79.8
July	599.1	592.5	8.46	7.86	128.2	126.9	80.6	79.9
August	601.5	595.5	8.57	7.97	128.3	127.3	80.4	80.0
September	603.8	596.6	8.69	8.05	128.5	127.8	80.3	80.1
October	606.4	599.9	8.65	8.01	128.7	128.3	80.2	80.2
November	610.7	602.5	8.60	8.13	128.8	128.6	80.0	80.2
December	615.5	604.8	8.61	8.23	128.7	128.9	79.7	80.2
January 1987	619.4	608.0	8.72	8.32	128.9	129.0	79.6	80.1
February	622.8	611.0	8.81	8.40	128.8	129.3	79.3	80.0
March	626.0	614.6	8.89	8.49	128.9	129.4	79.2	79.8

Fore. = February Forecast

C.E. = Current Expectations

* = This item and those beyond it are expectations.

PRICES

	CPI-U		PPI		PPI-Industrial		Estimated GNP	
	(seasonally adjusted)		Finished Goods (seasonally adjusted)		Commodities (unadjusted)		Deflator	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October 1985	324.6	324.9	294.4	294.4	324.4	324.2	112.7	112.5
November	326.2	326.7	296.7	296.7	325.0	325.0	113.0	113.0
December	327.8	327.9	297.9	298.3	325.2	325.2	113.2	113.5
January 1986	328.7	329.0	297.3	296.3	323.9	324.0	113.6	113.9
February	328.6	327.7	296.9	291.7	322.5	319.4	113.9	113.8
March	329.1	326.4	296.6	288.6	321.2	314.0	114.2	113.4
April	330.3	325.7*	296.9	288.1*	321.8	314.2*	114.4	113.3
May	331.5	326.3	297.1	288.7	322.2	314.6	114.7	113.6
June	332.7	327.2	297.8	289.3	322.5	315.1	115.0	113.9
July	333.4	328.1	298.4	290.0	322.9	315.9	115.3	114.2
August	334.1	329.2	298.9	290.9	323.2	316.8	115.6	114.5
September	334.8	330.1	299.4	291.7	324.2	314.9	115.9	114.8
October	336.1	331.2	299.9	292.6	323.9	317.7	116.3	115.1
November	337.4	332.4	300.5	293.8	324.8	318.4	116.6	115.5
December	338.7	333.5	301.2	294.6	325.7	319.3	117.0	115.9
January 1987	340.2	334.5	302.0	295.3	326.5	320.1	117.4	116.3
February	341.7	335.9	302.9	296.2	327.0	321.0	117.9	116.6
March	343.3	337.0	303.8	296.9	327.6	321.8	118.3	117.1

	Consumption		Consumer		Consumer		Consumer		Implicit	
	Deflator		Durables		Nondurables		Services		Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October 1985	113.1	112.5	104.7	104.3	108.8	108.3	118.7	118.3	169.0	170.4
November	113.8	113.1	105.2	104.4	109.1	109.1	119.1	118.8	168.8	171.2
December	114.2	113.5	105.6	104.5	109.9	109.8	119.6	119.1	168.9	171.6
January 1986	114.0	113.8	105.0	104.9	109.8	109.8	119.9	119.5	169.3	172.1
February	113.9	113.3	104.7	105.0	109.5	108.1	120.2	119.8	169.5	172.3
March	114.0	112.9*	104.5	105.0*	109.5	106.4*	120.5	120.3*	169.6	172.8*
April	114.4	112.7	104.7	105.3	109.7	105.3	120.9	120.7	170.0	173.2
May	114.9	113.0	104.9	105.5	109.9	105.5	121.6	121.2	170.6	173.7
June	115.3	113.3	105.1	105.7	110.1	105.8	122.2	121.5	171.1	174.2
July	115.6	113.6	105.3	105.9	110.3	106.0	122.8	121.9	171.6	174.7
August	115.9	114.0	105.5	106.0	110.4	106.3	123.2	122.4	172.0	175.1
September	116.2	114.3	105.7	106.0	110.5	106.5	123.6	122.9	172.4	175.4
October	116.7	114.7	106.0	106.3	110.9	106.8	124.1	123.3	173.0	176.0
November	117.1	115.1	106.2	106.5	111.5	107.1	124.8	123.8	173.8	176.5
December	117.5	115.5	106.4	106.7	112.0	107.4	125.5	124.4	174.5	177.0
January 1987	118.0	115.9	106.5	106.9	112.3	107.7	126.0	125.0	175.0	177.5
February	118.5	116.4	106.7	107.2	112.5	108.1	126.5	125.5	175.5	178.0
March	118.9	116.8	106.9	107.5	112.7	108.4	127.1	126.1	175.9	178.5

Fore. = February Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

MISCELLANEOUS

	Merchandise Trade Balance		Leading Indicators		Estimated GNP		Estimated GNP (1982 \$)		IVA (annual rate)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October 1985	-11.47	-14.01	171.3	171.2	4030	4028	3576	3578	-6.2	-6.2
November	-13.68	-12.81	171.5	171.5	4058	4052	3591	3586	-9.7	-11.2
December	-16.57	-14.91	173.6	174.1	4097	4098	3619	3608	-14.6	-14.7
January 1986	-14.93	-14.42	173.0	174.1	4133	4116	3638	3614	-0.6	0.8
February	-14.21	-12.49p	172.6	175.4	4154	4115	3647	3616	4.3	13.3
March	-11.59	-11.63*	173.0	176.4*	4176	4118	3657	3630	14.0	27.9
April	-13.29	-11.29	173.4	177.0	4198	4126	3670	3642	12.1	20.4
May	-13.85	-12.13	173.3	177.3	4215	4147	3675	3651	6.0	12.3
June	-13.26	-12.42	173.8	177.1	4233	4189	3681	3678	2.3	5.6
July	-13.46	-11.92	173.5	176.4	4254	4212	3690	3688	-1.0	2.3
August	-13.35	-11.78	173.2	177.0	4274	4240	3697	3703	-1.8	0.5
September	-13.23	-11.59	172.8	177.3	4295	4253	3706	3705	-1.9	-1.6
October	-13.69	-11.67	172.9	177.0	4319	4271	3714	3711	-4.7	-3.9
November	-13.49	-11.52	172.5	176.5	4346	4296	3727	3719	-9.3	-7.8
December	-13.28	-11.27	172.8	176.6	4375	4316	3739	3724	-14.2	-10.4
January 1987	-13.07	-10.96	172.5	176.0	4396	4349	3744	3739	-12.6	-5.3
February	-12.98	-10.88	171.6	175.5	4414	4363	3744	3742	-10.7	-7.8
March	-12.88	-10.99	171.4	175.6	4433	4387	3747	3746	-8.9	-9.5

Fore. = February Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

FINANCIAL MARKETS

	Monetary Base		M1		M2		Federal Funds		T-Bills (6 Mos.)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October 1985	231.3	232.0	611.1	614.2	2532.8	2538.3	7.99	7.99	7.33	7.33
November	232.7	233.0	617.9	620.1	2546.8	2550.7	8.05	8.05	7.30	7.30
December	235.0	234.8	624.5	626.6	2563.1	2565.5	8.27	8.27	7.09	7.09
January 1986	236.5	235.8	627.3	627.2	2582.7	2568.5	8.06	8.14	7.10	7.16
February	237.0	237.8	629.2	631.0	2603.5	2576.3	7.96	7.86	7.08	7.11
March	237.6	239.0	631.0	638.4	2624.1	2590.4	7.85	7.48	7.06	6.57
April	239.2	240.3*	633.7	642.8*	2636.7	2605.4*	7.53	7.07*	6.92	5.99*
May	240.9	241.4	636.2	645.0	2648.5	2618.4	7.42	6.63	6.89	5.73
June	242.5	242.3	638.6	647.4	2660.5	2636.7	7.31	6.47	6.85	5.54
July	243.8	243.2	641.1	649.1	2681.4	2652.5	7.25	6.75	6.82	5.82
August	245.1	244.4	645.8	652.1	2698.7	2671.1	7.31	7.08	6.86	6.05
September	246.4	245.5	650.5	654.7	2716.0	2687.1	7.37	7.26	6.88	6.26
October	248.0	246.7	653.4	657.5	2734.3	2703.2	7.59	7.53	7.13	6.48
November	249.1	248.1	656.9	661.2	2754.9	2722.1	7.63	7.52	7.21	6.59
December	250.2	249.5	660.4	665.4	2775.4	2739.4	7.68	7.55	7.28	6.67
January 1987	251.8	250.7	663.9	668.6	2791.3	2758.6	7.85	7.42	7.40	6.71
February	253.1	252.1	667.4	671.8	2809.1	2777.9	7.93	7.48	7.46	6.70
March	254.4	253.0	671.1	674.2	2826.9	2794.6	7.82	7.55	7.40	6.75

	Aaa (Seasoned)		Municipals (Bond Buyer)		(3 Month) Commercial Paper		90 Day CD's		Prime Rate	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
October 1985	11.02	11.02	9.08	9.08	7.80	7.80	7.88	7.88	9.50	9.50
November	10.55	10.55	8.54	8.54	7.77	7.77	7.81	7.81	9.50	9.50
December	10.16	10.16	8.43	8.43	7.75	7.75	7.80	7.80	9.50	9.50
January 1986	10.05	10.05	8.27	8.08	7.72	7.71	7.84	7.82	9.50	9.50
February	10.12	9.67	8.25	7.44	7.63	7.63	7.75	7.69	9.50	9.50
March	10.08	9.00	8.09	7.08	7.56	7.20	7.71	7.24	9.50	9.10
April	9.84	8.74*	7.63	7.23*	7.52	6.75*	7.67	6.73*	9.50	8.83*
May	9.73	8.46	7.52	6.94	7.28	6.43	7.48	6.48	9.19	8.50
June	9.63	8.27	7.41	6.74	7.16	6.25	7.35	6.37	9.00	8.27
July	9.44	8.47	7.26	6.88	7.11	6.48	7.29	6.53	9.00	8.00
August	9.49	8.69	7.28	7.13	7.26	6.75	7.42	6.85	9.00	8.00
September	9.53	8.81	7.35	7.22	7.42	7.09	7.63	7.18	9.00	8.46
October	9.55	8.96	7.36	7.37	7.65	7.26	7.78	7.41	9.00	8.78
November	9.58	9.02	7.40	7.51	7.72	7.55	7.95	7.64	9.00	9.00
December	9.61	9.07	7.44	7.64	7.79	7.70	8.14	7.86	9.00	9.00
January 1987	9.88	9.05	7.62	7.54	7.93	7.84	8.23	8.01	9.08	9.24
February	9.95	9.11	7.74	7.49	7.99	7.73	8.30	7.92	9.50	9.50
March	9.96	9.15	7.77	7.50	7.95	7.62	8.27	7.86	9.50	9.50

Fore. = February Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

Georgia State University

a unit of the university system of georgia

university plaza
atlanta, georgia 30303-3083

college of business administration
economics forecasting center
404 524-3252

MONTHLY PROJECTIONS May 1986

Dr. Donald Ratajczak, Director
For Release: June 4, 1986

SECOND-HALF SURGE MOSTLY IN PRICES

Changes in desired inventories continue to create unstable price movements in oil products. When oil prices were falling from \$28 per barrel to less than \$10 on the spot market, desired inventories fell sharply below inventories actually on hand. As a result, inventory liquidations accentuated the downward movement of oil prices. When the beginning of the driving season began in May, unusually low inventory holdings generated price increases. Soon, rising prices led to increases in desired inventories relative to those on hand. Once again, inventory holdings caused prices to overadjust relative to underlying demand and supply conditions. Prices again moved downward soon after inventories grew more rapidly than the quantity demanded. However, it is increasingly evident that oil prices will be stabilizing near \$15 per barrel until significant changes occur either in supply conditions or in basic demand. Some price firming probably will develop during the fall, but oil prices now are not anticipated to exceed \$17 per barrel for any sustained period of time prior to the fall of 1987.

Although fluctuating oil prices suggest that monthly inflation statistics could be erratic over the next few months, most of the deflationary impact from falling oil prices already are in the price indices. Because of further significant price declines for natural gas, the PPI in May is expected to remain unchanged, but will be rising significantly for the remainder of 1986. Large increases in prices of service components should cause the CPI to increase 0.3% in May, ending a string of three consecutive declines. Already, falling mortgage rates have led to a significant rebound in construction activity and construction costs. The implicit construction deflator in April increased 0.8%. While some of that is expected to be statistical and will be reversed next month, this suggests that inflationary pressures will be building significantly into the third quarter. For example, the GNP deflator, which grew only 2.5% in the first quarter and is projected to increase only 0.4% in the second quarter, will be rising more than 4% in the second half of 1986. Because of this intensifying inflationary pressure, expenditures before adjustment for price changes will be growing nearly twice as rapidly during the second half of this year as in early months.

Although spending is expected to grow more briskly later in 1986, the inflation-adjusted magnitude of spending should not intensify. While everyone was bemoaning the absence of consumer spending during the first four months of 1986, inflation-adjusted consumer spending grew at a surprisingly brisk 6.7% rate. With the aid of incentives, automobile sales once again moved above 11 million units. Furniture and hardware sales moved briskly upward in response to improving housing activity. Although consumer savings also appeared to spurt in April, this increase was the result of government subsidies to farmers. Typically, crop support payments enter almost completely into savings during the month in which they are disbursed, as farmers use these funds to pay off debts. In fact, personal savings has remained near the \$125 billion annual rate that has been sustained since the beginning of the year. In short, the consumer already has been spending the benefits from declining gasoline prices. However, most people have been waiting for dollar valued increases in sales and have failed to recognize that inflation-adjusted activity has been growing rapidly.

Indeed, auto sales are not projected to grow from current levels during the remainder of 1986. While furniture and hardware stores will continue to show real growth throughout the year, sales of inflation-adjusted nondurable goods will slow their growth during the second half. Also, some of the rapid growth in services reflects unusually high volume activity in financial markets. As this activity is expected to diminish later in the year, even the service component will grow more slowly in inflation-adjusted terms. Thus, consumption will not support economic growth as much during the second half of 1986 as it did in the first half.

Construction should continue to provide increasing economic growth until the two million housing starts that have prevailed so far this year are completely factored into residential expenditures. This should occur by July. About that time, multi-family units should begin trending downward. By the end of this year, starts should be growing less than 1.8 million units as funds available to support rental units begin evaporating. (Provisions of the tax bill will ensure reduced funding for such construction activity.) Also, nonresidential construction will resume its decline following a summer surge in order to build-out facilities now under construction. Again, proposed tax changes significantly increase the value of completions in 1986 at the expense of subsequent years. Because of these tax considerations, construction spending is now expected to reach its peak early in the third quarter and then decline well into 1987.

Although inventory accumulation should intensify later in 1986 as industrial prices begin firming, the \$2.5 billion increase in inventories during March will not be exceeded until the fall. In effect, automobile production was excessive and is now being reduced to provide a better balance with underlying sales conditions. Thus, upward revision in inventory investments during the first quarter leads to reduced projections of economic gain in the summer months.

Of course, not all sectors of the economy will be growing more slowly later in 1986. Following a significant drop during the first few months, capital shipments should grow modestly over the next year. The anticipated repeal of the investment tax credit will modestly reduce orders for capital goods, but the projected impact is expected to be slight. A rebound in defense shipments also should add to economic activity in the remaining quarters of 1986, following a surprising period of weakness during the first quarter.

Also contributing to improving economic conditions in the next few quarters will be a modest downward trend in the trade deficit. The trade deficit fell sharply within the first quarter and between the first and second quarters, but much of this decline reflected reduced dollar values for the volume of petroleum entering the United States. Some reduction in the volume of petroleum products also occurred as inventories were being liquidated, which should have had no effect upon measured GNP because inventories and imports both should decline by similar amounts. However, there is a growing likelihood that the GNP accounts are incorrectly handling the inventorying of imported goods. For example, both in the fourth quarter of 1984 and the fourth quarter of 1985, a surge in imports reduced measured gains in GNP. However, no offsetting production curtailment occurred during those quarters in the United States. Instead, those products were probably inventoried but were not captured in the inventory measures for that quarter. In the subsequent quarter, when the goods were counted either in inventories or final sales, GNP rebounded. Again, no evidence of a rebound in domestic production corresponded to these gains.

Excluding the inventorying problem associated with imported goods, a gradual decrease in the value of merchandise trade deficits along with a significant decline in the volume imbalance should develop. For example, real GNP by 1987 is expected to be \$20 billion higher than would have occurred if no change in trade volumes had developed.

The case for greater real growth during the second half of 1986 must rest upon increased growth in capital spending, increased government purchases, improving trade balances, and increased inventory investment. While these sectors are formidable, they must offset apparent slowing in the growth contributions from consumption and construction. On balance, economic growth in the second half of 1986 probably will be slightly less than during the first six months after adjustment for inflation.

Of course, increased inflationary pressures, continued growth in mortgage activity until the fourth quarter, and increasing inventory investment all suggests that interest rate pressures will intensify. Already, the Federal Reserve has been forced to accept accelerated gains in monetary aggregates in order to preserve short-term interest rates slightly below 7%. The Federal Reserve may be willing to pursue such a policy as long as the dollar does not fall significantly in value and as long as inflationary pressures do not significantly intensify. However, inflation is expected to become more significant in the latter half of 1986 while reduced capital gains potential will turn non-Japanese foreign investors away from U. S. investment instruments. Although this withdrawal from the American market by foreign investors will not be sufficient to dramatically alter the course of those markets, it will reassert downward pressures upon the dollar's value. In this economic climate, the Federal Reserve certainly cannot encourage further downward movement in short-term interest rates. Indeed, the Federal Reserve may be forced to restrain reserve growth in an effort to slow inflationary pressures later this year.

Finally, moderate increases in interest rates and the effects of anticipated tax changes probably will stall the upward advance of stock market values late in 1986. Although our valuation formulas suggest that equity values could increase by an additional 10%, proposals to significantly increase the tax rates on capital gains by effectively eliminating the differential between capital income and normal income for individuals will probably lead to significant sales of equity positions near the end of 1986. In short, unless transition rules are

enacted to forestall the liquidation of large positions commanding capital gains, a significant stock market decline should be anticipated prior to the end of 1986. Of course, the market would then be in a position to rally even as economic conditions deteriorate in 1987.

Quarterly Profile of GNP

	<u>1986-1</u>	<u>1986-2</u>	<u>1986-3</u>	<u>1986-4</u>	<u>1987-1</u>	<u>1987-2</u>	<u>1986 Annual</u>
Real:	3.7	3.6	3.0	2.6	2.0	2.0	2.7
Price:	2.5	0.4	4.3	4.6	4.2	3.2	2.7
Nominal:	6.3	4.1	7.5	7.4	6.2	5.4	5.5

Monthly Statistical Highlights for May 1986

Payroll employment +223,000; index of hours worked +0.2%; household employment +274,000; civilian unemployment rate 7.1%; personal income -0.6%; savings rate 4.2%; personal consumption +0.4%; retail sales +0.3%; auto sales 11.2 million; housing starts +0.5%; housing permits -0.7%; construction expenditures +1.4%; business inventories +0.2%; orders for durable goods +0.7%; orders for nondefense capital goods +3.0%; industrial production +0.3%; CPI +0.3%; PPI +0.0%; consumption deflator +0.4%; leading indicators +0.5%; real GNP 3.3%; M1 20.0%; M2 10.0%.

Monthly Statistical Highlights for June 1986

Payroll employment +235,000; index of hours worked +0.3%; household employment +325,000; civilian unemployment rate 6.9%; personal income +0.6%; savings rate 4.5%; personal consumption +0.3%; retail sales -0.1%; auto sales 10.7 million; housing starts -3.9%; housing permits -5.4%; construction expenditures +0.9%; business inventories +0.2%; orders for durable goods +0.6%; orders for nondefense capital goods +3.3%; industrial production +0.4%; CPI +0.3%; PPI +0.4%; consumption deflator +0.3%; leading indicators -0.2%; real GNP 2.0%; M1 +7.0%; M2 +8.2%.

COMMENTARY

Employment - Despite a significant dip in the index of hours worked during February, the index grew almost as rapidly as GNP in the winter quarter. The discrepancy between this measurement of labor inputs and the measurement used to generate productivity gains cannot be explained.

Despite a sharp rebound in agricultural employment following heavy rains earlier in the year, household employment grew more slowly than payroll employment in April. In the past twelve months, household employment has trailed payroll employment by nearly a million jobs. The hourly earnings index declined slightly in April and is only 2.5% above previous year levels. This moderation in wage inflation has been responsible for much slower growth in wage and salary income than originally projected. However, more rapid increases are expected in hourly earnings once consumer prices again rebound following the termination of oil price declines.

Personal Income & Outlays - More than \$30 billion of increased subsidies to farmers accounted for a surprising 1.2% increase in personal income during April. These subsidies should vanish in May, causing personal income to dip by \$20 billion. Wage and salary income grew more slowly than anticipated in April, partially as a result of declining earnings. A rebound in both earnings and hours worked should lead to more rapid gains in the wage and salary component during May.

A sharp rebound in automobile sales during April led to a significant jump in purchases of durable goods. Although nondurable sales declined, all of the falloff was the result of declining prices. In the services component, however, some of the slowing reflected reduced stock market trade activity. Indeed, service expenditures probably will be growing more slowly in the second quarter to reflect the reduced significance of imputed financial services. Although an imputed deflator is not yet available for April, our analysis suggests that another significant gain occurred in inflation-adjusted consumer spending.

Further gains are expected in durable goods spending in May as auto incentives continue to generate significant sales. In addition, nonauto durables are expected to continue growing rapidly in response to rising housing sales. However, the impact of auto incentives should gradually diminish, leading to reduced unit sales during the summer months.

Clearly, the 0.5% gain in retail sales during April reflects dramatic increases in inflation-adjusted sales when the consumer deflator is falling 0.3%. Although retail sales are expected to grow at comparable dollar values in May, an increase in prices will mean that the gains are modest after adjustment for inflation.

Construction - As expected, multi-family units grew in excess of 750,000 during the first four months of 1986. This corresponds with rapid multi-family growth early in 1985. Because of developing tax legislation that will sharply reduce the attractiveness of such investments, multi-family starts are expected to begin falling sharply in June. By the end of the year, multi-family activity will be growing by less than 600,000 units. This will also be reflected in declining housing permits.

Single-family activity also should slow slightly late in the year as the surge in family sales slowly evaporates during the summer.

Nonresidential construction fell sharply in March and April. At the present time, these declines appear to be too early to reflect the topping out of nonresidential orders. Therefore, a rebound is expected in the next few months. However, economic conditions are deteriorating for nonresidential construction activity. It is, therefore, possible that projections still are being overstated for nonresidential activity. If so, construction activity in the second and third quarter will not be as robust as currently projected.

More significantly, the implicit construction deflator surged by 0.8% in April. We are currently viewing this as a statistical fluke that will partially be rectified in the next month. If this is a true surge in construction costs, real construction expenditures will be growing more slowly than currently projected. In any event, real construction expenditures will not reach the levels projected in the May forecast.

Business Activity - Inventories rebounded more sharply in March than had been anticipated. As a result, first quarter GNP estimates may be revised upward. Much of the increase in inventories in March reflected unwanted auto inventories, as 1.1 percentage points of the 1.2% increase in retail inventories was in automobiles. Automobile production now is below auto sales, suggesting that inventories of automobiles will be liquidated. As a result, much slower rates of gain in business inventories are expected in the next few months.

Partially offsetting the weakness in inventory accumulation will be intensifying activity for defense goods and some modest growth in capital spending. However, shipments of capital goods in April fell slightly below March levels. This probably reflected the absence of any significant orders growth in the past few months. We are anticipating a significant rebound in orders for capital goods in the next few months as a result of more favorable capital costs. However, those orders are not yet in the statistics.

Defense orders have slowed significantly in the past month following an earlier surge of orders. A rebound in defense orders is expected again in the next few months. As a result, orders for durable goods should rebound slightly into the summer.

Industrial production should begin accelerating in the next few months. Weakness has occurred in consumer goods and in business equipment. If business equipment orders pick up, as expected, some rebound in industrial production should materialize in the next few months. This will generate some improvement in capacity utilization, leading to further strengthening in capital goods orders, at least until the end of this year.

Prices - Although oil prices no longer appear to be falling, declining natural gas prices led to another unchanged pattern for finished goods. Service prices are beginning to explode, however, causing the CPI to rise by 0.3% in May. The sharp increase in service prices is related to significant gains in housing costs. These prices are expected to moderate later this year, leading to no significant deviation from current inflationary projections.

However, food prices probably are going to rise slightly more than had been projected a month ago as a result of less concentrated slaughtering of dairy cattle than previously anticipated. Therefore, the nondurable deflator is expected to grow more sharply in the second half of 1986 than projected in our forecast. This causes a slight acceleration of inflationary pressure during the second half of the year.

Miscellaneous - The leading indicators have responded sharply to declining prices and a rising stock market. In addition, consumer credit has also rebounded sharply. When prices begin rising, stock prices are not expected to rebound sharply while real money balances may fall slightly in some months. Also, building permits and orders for both plant and equipment and consumer goods should show little growth in the second half of 1986. As a result, the leading indicators probably will plateau during the summer months and then begin falling early in 1987.

FINANCIAL MARKETS

Following the surge in inventories during March, decreases in inventory investment coincided with continued declines in prices in April. Therefore, rates on commercial paper plunged sharply. Now that inventories are again rebuilding and inflation is beginning to intensify, commercial paper rates have begun firming. The Federal Reserve has discovered that it cannot maintain its targeted 6.75% federal funds rate and also maintain a relatively modest growth in monetary aggregates. Both the monetary base and all the monetary aggregates grew excessively in May. Activity is not expected to be as intense in the next few months as the monetary aggregates once again slow. Nevertheless, the Federal Reserve probably will abandon its interest rate target in order to control money growth in an environment of increasing inflationary pressure before the end of summer. During the latter part of 1986 the federal funds target is expected to be 7.5%. This will necessitate an increase in the prime rate to at least 9%.

Theoretically, long-term interest rates could continue to trend downward on the basis of high real returns, especially after tax changes reduce the marginal tax rate to savers. However, the financing cost of holding bond inventories will soon exceed the yields provided by long-term government bonds. Thus, investors probably would be reluctant to hold bonds at yields that required anticipated capital gains when short-term interest rates were trending upward. While long-term interest rates are not expected to rise dramatically, (for example, the mortgage rate probably will only peak at 10.5% late in 1986) some increase in long-term rates should be anticipated.

Tax changes probably will reduce the attractiveness of municipal bonds relative to taxable bonds. Indeed, the tax reform program appears to favor taxable bonds relative to all other portfolio investments while slightly disfavoring tax exempt issues. Most tax shelters are significantly out of favor. The gap between yields on the bond buyer and the corporate AAA should narrow to where the bond buyer is yielding more than .85 times the corporate AAA. Tax exempt issues then may rally more significantly than taxable bonds early in 1987, especially as some limitations on the issuance of tax exempt bonds may reduce the supply early in 1987.

Equity Markets

The equity markets are struggling with prospects of improving profits offset by diminishing evaluations of profits because of rising interest rates. In the spring and early summer, the increase in interest rates should be sufficiently subdued, especially as measured by corporate AAA yields while the potential for improving operating profits less tax liability should be sufficiently beneficial that equity values could rise above 2000 as measured by the Dow Jones index. Profit prospects late in 1986 should gradually dissipate while interest rates are expected to continue rising, at least into the early months of 1987. Normally, this outlook would necessitate a modest reduction in equity values.

However, if no transitional adjustments are made to the Senate tax proposals, capital gains will effectively be taxed at 27% in 1987 as opposed to a 20% cap in 1986. Many investors with substantial capital gains may choose to take the last opportunity to receive reduced tax treatment by selling their holdings late this year. These tax-induced transactions could lead to a relatively significant decline in equity values. While any estimates would be hazardous, because it is based upon unexercised capital gains, a statistic that is not readily available, a stock market correction of 20-30% late in 1986 cannot be ruled out. Indeed, some investors may anticipate eroding capital values and begin liquidating their long-term holdings soon after the tax reform package is enacted, if no transitional rule for capital gains is initiated. Whether such transitional legislation emerges in the tax conference will not be known until after Labor Day. Therefore, a summer stock market rally can ignore the ominous near-term cloud raised by the transition to a new tax code, but investors should be advised to liquidate positions during the fall.

EMPLOYMENT

	Payroll Employment		Index of Hours Worked		Household Civilian Employment		Civilian Unemployment Rate		Hourly Earnings Index	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1986	99496	99496	119.1	119.1	108955	108955	6.7	6.7	167.4	167.4
February	99649	99656	118.5	118.6	108561	108561	7.2	7.3	168.4	168.5
March	99841	99834	118.9	119.0	108788	108788	7.2	7.2	168.8	168.9
April	100029	100040	119.2	119.1	109024	108892	7.1	7.1	169.2	168.8
May	100296	100263*	119.5	119.3*	109265	109166*	7.0	7.1*	169.3	169.3*
June	100563	100498	119.8	119.6	109512	109491	7.0	6.9	169.5	169.7
July	100778	100729	120.1	119.8	109773	109719	6.9	6.9	170.2	170.1
August	100972	100958	120.5	120.1	109975	109965	6.8	6.9	170.8	170.6
September	101065	101184	121.0	120.4	110178	110228	6.7	6.8	171.4	171.1
October	101397	101367	121.2	120.6	110418	110453	6.7	6.8	171.9	171.6
November	101649	101532	121.4	120.8	110753	110626	6.6	6.7	172.5	172.2
December	102015	101706	121.6	121.0	111130	110848	6.5	6.7	173.1	172.8
January 1987	102098	101935	121.8	121.3	111275	111098	6.5	6.6	173.5	173.4
February	102197	102116	121.9	121.5	111358	111310	6.5	6.6	173.9	173.9
March	102295	102272	122.0	121.7	111439	111489	6.4	6.5	174.4	174.4
April	102468	102443	122.2	121.9	111694	111659	6.4	6.5	174.9	174.9
May	102705	102607	122.5	122.1	111918	111854	6.3	6.5	175.4	175.5
June	102921	102791	122.8	122.2	112142	112079	6.3	6.5	176.0	176.0

PERSONAL INCOME

	Personal Income		Wage & Salary		Personal Savings		Disposable Income		Personal Outlays	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1986	3.387	3.386	2.027	2.027	124.7	124.4	2.882	2.882	2.758	2.758
February	3.401	3.402	2.034	2.034	125.7	124.9	2.896	2.897	2.771	2.772
March	3.407	3.408	2.044	2.044	122.9	129.7	2.904	2.904	2.781	2.775
April	3.432	3.447	2.052	2.048	127.8	159.0	2.926	2.942	2.788	2.783
May	3.429	3.427*	2.062	2.059*	127.3	123.5*	2.921	2.919*	2.794	2.796*
June	3.435	3.446	2.073	2.071	124.0	131.0	2.928	2.935	2.805	2.804
July	3.459	3.462	2.081	2.080	121.9	125.6	2.944	2.948	2.822	2.822
August	3.482	3.482	2.092	2.093	121.7	125.6	2.962	2.964	2.841	2.838
September	3.506	3.504	2.103	2.105	121.7	126.5	2.981	2.982	2.860	2.855
October	3.526	3.525	2.113	2.117	118.7	130.3	2.996	2.999	2.878	2.869
November	3.547	3.543	2.125	2.129	120.7	126.9	3.012	3.013	2.892	2.886
December	3.569	3.562	2.137	2.142	123.0	128.6	3.029	3.028	2.906	2.899
January 1987	3.575	3.577	2.148	2.152	120.7	139.4	3.042	3.053	2.922	2.914
February	3.598	3.600	2.158	2.168	120.6	147.2	3.061	3.074	2.940	2.927
March	3.633	3.618	2.168	2.179	132.4	144.9	3.090	3.089	2.958	2.944
April	3.640	3.637	2.179	2.191	116.6	145.9	3.094	3.105	2.977	2.959
May	3.649	3.656	2.187	2.203	104.8	142.2	3.098	3.120	2.993	2.978
June	3.659	3.672	2.196	2.213	96.7	138.2	3.104	3.132	3.009	2.993

Fore. = May Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

CONSUMPTION

	Personal Consumption		Durables		Nondurables		Services		Consumption Real	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1986	2659.6	2659.4	368.8	368.8	933.9	933.9	1356.9	1356.6	2337.3	2336.9
February	2671.5	2673.0	364.0	367.6	935.0	933.8	1372.5	1371.6	2357.5	2357.6
March	2680.8	2674.8	354.4	355.9	948.6	940.3	1377.8	1378.7	2374.4	2368.3
April	2687.0	2682.5	365.0	369.5	936.4	930.9	1385.6	1382.0	2382.1	2375.1*
May	2692.3	2694.5*	366.2	372.1*	930.2	932.1*	1395.9	1390.3*	2378.4	2378.6
June	2706.1	2702.4	364.7	365.7	935.1	938.3	1406.3	1398.4	2380.0	2378.1
July	2723.5	2720.1	369.8	368.2	939.2	944.1	1414.5	1407.8	2389.0	2384.9
August	2736.4	2735.4	371.6	368.2	943.8	950.9	1421.0	1416.3	2396.1	2387.1
September	2750.0	2751.8	374.1	368.3	948.3	958.7	1427.6	1424.8	2403.8	2393.3
October	2769.3	2764.3	376.8	367.7	955.7	963.5	1436.8	1443.1	2412.3	2394.5
November	2786.4	2781.0	379.2	370.8	960.3	968.0	1446.9	1442.2	2414.6	2398.9
December	2798.5	2793.6	380.6	372.1	960.7	971.2	1457.2	1450.3	2412.5	2400.0
January 1987	2813.7	2807.1	381.9	372.6	966.5	975.7	1465.3	1458.9	2419.3	2403.7
February	2830.0	2819.5	381.6	371.9	973.8	980.9	1474.6	1466.7	2425.0	2406.4
March	2846.9	2836.0	381.0	374.3	981.4	986.4	1484.5	1475.2	2431.2	2412.3
April	2867.7	2850.1	387.4	376.7	986.5	989.1	1493.8	1484.3	2440.6	2417.9
May	2880.4	2867.9	386.7	376.5	990.7	994.9	1503.0	1494.5	2441.0	2425.6
June	2890.7	2882.5	386.8	379.6	991.6	999.6	1512.3	1503.2	2439.4	2428.8

RETAIL SALES

	Retail Sales		Non-Auto Durables		Auto (Million Units)		Nondurable Sales		Auto Sales	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1986	117.35	117.35	17.86	17.86	11.5	11.5	73.16	73.16	26.33	26.33
February	117.45	117.20	17.97	17.91	10.6	10.6	73.25	73.25	26.04	26.04
March	116.17	116.17	18.07	18.15	9.7	9.7	73.19	73.19	24.83	24.83
April	116.43	116.79	18.05	18.35	10.6	11.1	72.25	72.59	26.13	25.85
May	116.10	117.19*	18.12	18.43*	10.5	11.2*	71.77	72.68*	26.21	26.08*
June	116.40	117.12	18.20	18.52	10.4	10.7	72.15	73.17	26.05	25.43
July	116.94	117.87	18.36	18.60	10.4	10.8	72.47	73.62	26.11	25.65
August	116.97	118.20	18.53	18.68	10.2	10.6	72.82	74.15	25.62	25.37
September	117.62	118.81	18.62	18.79	10.3	10.5	73.17	74.76	25.83	25.26
October	118.51	119.12	18.60	18.92	10.5	10.3	73.74	75.13	26.17	25.07
November	119.34	119.84	18.72	19.03	10.8	10.4	74.09	75.48	26.53	25.33
December	119.54	120.24	18.79	19.01	10.8	10.4	74.12	75.73	26.63	25.50
January 1987	120.14	120.65	19.02	19.11	10.7	10.3	74.57	76.08	26.55	25.46
February	120.67	120.98	19.07	19.20	10.6	10.2	75.13	76.49	26.47	25.29
March	121.19	121.70	19.15	19.31	10.5	10.3	75.72	76.92	26.32	25.47
April	122.34	122.19	19.31	19.38	10.9	10.4	76.11	77.13	26.92	25.68
May	122.59	122.76	19.42	19.45	10.7	10.5	76.44	77.58	26.73	25.83
June	122.67	123.06	19.58	19.52	10.5	10.5	76.51	77.95	26.58	25.89

Fore. = May Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

MISCELLANEOUS

	Merchandise Trade Balance		Leading Indicators		Estimated GNP		Estimated GNP (1982 \$)		IVA (annual rate)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1986	-14.93	-16.46	174.1	174.1	4116	4118	3614	3615	0.8	1.6
February	-14.21	-12.49	175.4	175.4	4115	4121	3616	3621	13.3	14.8
March	-14.03	-14.52	176.4	176.6	4118	4124	3631	3637	27.9	34.3
April	-12.73	-12.07p	177.3	179.2	4127	4139	3633	3647	30.3	34.8
May	-12.52	-11.38*	178.2	180.1	4156	4162	3649	3657	14.2	30.6
June	-12.32	-12.46	178.4	179.7	4203	4183	3680	3663	6.2	17.4
July	-11.96	-11.98	178.2	179.4	4221	4216	3690	3679	1.6	8.6
August	-12.06	-12.16	177.5	179.8	4241	4233	3697	3678	-3.5	3.5
September	-12.20	-12.35	178.0	179.2	4262	4260	3706	3691	-8.3	-1.7
October	-12.15	-12.06	178.3	179.6	4288	4291	3716	3703	-8.0	-3.2
November	-12.03	-11.72	178.7	180.4	4315	4308	3726	3704	-7.2	-3.8
December	-11.90	-11.84	178.3	180.1	4342	4330	3737	3711	-6.5	-5.7
January 1987	-11.95	-11.61	177.2	179.5	4363	4359	3739	3722	-6.6	-7.2
February	-11.91	-11.24	177.3	179.0	4385	4370	3745	3719	-10.9	-9.1
March	-11.86	-11.52	176.8	179.6	4406	4400	3750	3732	-12.5	-11.6
April	-11.80	-11.60	176.1	179.0	4424	4420	3752	3743	-12.1	-10.4
May	-11.72	-11.42	175.5	178.3	4440	4430	3753	3741	-11.6	-9.1
June	-11.64	-11.16	175.3	178.0	4455	4449	3753	3745	-11.4	-10.2

Fore. = May Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections

PRICES

	CPI-U		PPI		PPI-Industrial		Estimated GNP	
	(seasonally adjusted)		Finished Goods (seasonally adjusted)		Commodities (unadjusted)		Deflator	
	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.
January 1986	329.0	329.0	296.3	296.3	324.0	324.0	113.9	113.9
February	327.7	327.7	291.7	291.7	319.4	319.4	113.8	113.8
March	326.4	326.4	288.6	288.6	314.0	314.0	113.4	113.4
April	325.5	325.2	287.1	286.6	209.6	311.2	113.6	113.5
May	325.9	326.2*	287.8	286.6*	310.9	311.0	113.9	113.8
June	326.6	327.1	298.5	287.7	312.3	312.6	114.2	114.2
July	327.7	328.5	290.3	288.5	313.4	313.9	114.4	114.6
August	328.8	329.8	291.0	289.3	314.7	315.0	114.7	115.1
September	330.0	330.9	291.7	290.2	311.6	312.9	115.0	115.4
October	331.0	332.0	292.3	291.3	315.8	315.6	115.4	115.9
November	331.9	333.1	293.5	292.3	316.1	316.2	115.8	116.3
December	332.8	334.2	294.5	293.6	316.5	316.8	116.2	116.7
January 1987	334.3	335.1	295.2	294.2	317.0	317.3	116.7	117.1
February	335.9	336.1	295.9	294.9	317.8	317.9	117.1	117.5
March	337.5	337.3	296.6	295.5	318.5	318.6	117.5	117.9
April	338.6	338.0	297.3	296.3	319.4	319.3	117.9	118.1
May	339.7	339.1	298.1	297.1	320.3	320.0	118.3	118.4
June	340.6	340.2	298.9	298.0	321.2	320.8	118.7	118.8

	Consumption		Consumer		Consumer		Consumer		Implicit	
	Deflator		Durables		Nondurables		Services		Construction	
	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.
January 1986	113.8	113.8	104.9	104.9	109.8	109.8	119.5	119.6	172.1	172.1
February	113.3	113.4	105.0	105.2	108.1	108.0	119.8	119.9	172.3	172.3
March	112.9	112.9	105.0	104.7	106.8	106.7	120.3	120.2	172.8	172.9
April	112.8	112.9*	105.2	105.0*	106.1	106.0*	120.6	120.7*	173.3	174.3
May	113.2	113.3	105.3	105.2	106.0	106.3	121.0	121.1	173.9	174.1*
June	113.7	113.6	105.5	105.4	106.2	106.6	121.4	121.5	174.4	174.5
July	114.0	114.1	105.6	105.6	106.4	107.0	122.0	122.0	175.0	175.0
August	114.2	114.6	105.7	105.8	106.5	107.7	122.7	122.5	175.6	175.5
September	114.4	115.0	105.8	105.8	106.7	108.1	123.4	123.0	176.1	176.1
October	114.8	115.4	106.1	106.2	107.1	108.4	123.8	123.6	176.6	176.6
November	115.4	115.9	106.4	106.5	107.6	108.7	124.1	124.3	177.2	177.0
December	116.0	116.4	106.7	106.7	108.1	109.0	124.5	125.0	177.8	177.5
January 1987	116.3	116.8	107.0	106.9	108.4	109.3	125.0	125.5	178.3	178.0
February	116.7	117.2	107.3	107.1	108.7	109.7	125.6	125.9	178.8	178.4
March	117.1	117.6	107.6	107.4	109.0	110.0	126.1	126.4	179.4	179.0
April	117.5	117.9	107.9	107.7	108.9	110.2	126.7	126.8	179.9	179.5
May	118.0	118.2	108.2	108.0	109.0	110.4	127.3	127.3	180.5	179.9
June	118.5	118.7	108.5	108.3	109.2	110.7	128.0	127.9	181.0	180.4

Fore. = May Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

BUSINESS ACTIVITY

	Manufacturers' Inventories		Durable Goods Orders		Non-Defense Capital Goods Orders		Non-Defense Capital Shipments	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1986	280.4	280.4	108.46	108.19	24.55	24.29	25.60	25.35
February	279.5	279.5	107.82	107.55	28.91	28.64	26.86	26.56
March	278.7	279.6	105.07	104.68	27.02	26.54	27.82	27.30
April	278.2	279.2	105.09	104.51	27.20	26.08	27.40	27.20
May	279.0	279.1*	106.01	105.24*	27.63	26.87*	27.58	27.32*
June	280.3	279.6	105.84	105.83	27.85	27.76	27.76	27.51
July	281.1	280.3	107.13	105.02	28.46	27.05	27.85	27.70
August	282.2	281.1	106.67	107.26	28.40	28.42	27.97	27.83
September	283.2	282.2	108.23	106.84	28.86	28.29	28.09	27.92
October	284.4	283.5	108.84	106.99	29.16	28.53	28.35	28.13
November	286.3	284.8	109.28	108.13	29.33	28.82	28.63	28.41
December	287.4	286.2	108.89	108.56	29.30	29.04	28.91	28.60
January 1987	288.8	287.9	108.37	108.21	29.21	29.07	29.05	28.74
February	290.3	289.5	109.52	108.13	29.34	28.86	29.11	28.87
March	292.5	291.5	109.76	108.82	29.22	29.13	29.17	29.12
April	294.9	293.9	108.83	107.65	29.12	28.72	29.35	29.25
May	296.2	295.7	108.72	107.23	29.18	28.55	29.48	29.20
June	298.0	297.3	108.85	106.94	29.30	28.13	29.61	29.42

	Business Inventories		Defense Shipments		Industrial Production		Capacity Utilization	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1986	585.0	585.0	7.03	7.03	126.6	126.7	80.7	80.8
February	585.1	585.2	7.58	7.58	125.7	125.7	80.0	80.0
March	585.8	587.7	7.27	7.08	125.1	124.9	79.4	79.3
April	587.0	588.3*	7.40	7.38	125.5	125.1	79.5	79.3
May	588.1	589.4	7.49	7.43*	125.8	125.5*	79.5	79.4*
June	589.9	590.5	7.59	7.50	126.4	126.0	79.7	79.6
July	591.2	592.1	7.68	7.57	127.2	126.3	80.0	79.6
August	593.5	593.8	7.85	7.80	127.8	126.8	80.2	79.8
September	595.7	596.3	8.05	7.94	128.4	127.2	80.4	79.9
October	598.2	599.7	8.01	8.06	128.6	127.6	80.4	80.0
November	600.3	602.5	8.07	8.15	128.8	127.9	80.4	80.0
December	602.4	605.5	8.18	8.22	129.0	128.1	80.3	80.0
January 1987	605.8	609.3	8.25	8.29	128.9	128.1	80.1	79.8
February	609.9	612.5	8.33	8.34	129.1	128.1	80.1	79.8
March	613.9	616.7	8.40	8.43	129.2	128.4	80.0	79.6
April	617.1	621.3	8.38	8.40	128.8	128.8	79.7	79.6
May	620.8	625.1	8.45	8.46	128.5	129.1	79.4	79.6
June	623.3	628.0	8.52	8.53	128.2	129.3	79.1	79.5

Fore. = May Forecast

C.E. = Current Expectations

* = This item and those beyond it are expectations.

CONSTRUCTION

	Housing Starts		Single Family Starts		Housing Permits		Construction Expenditures (Current)		Construction Expenditures (Real)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1986	2.034	2.034	1.335	1.335	1.899	1.861	356.1	355.1	206.9	206.3
February	1.997	2.001	1.204	1.202	1.803	1.808	360.5	358.8	209.2	208.3
March	1.949	1.930	1.212	1.207	1.846	1.834	367.2	353.9	212.5	204.7
April	1.966	2.009	1.256	1.256	1.833	1.883	368.4	356.7	212.6	204.6
May	1.940	2.019*	1.237	1.283*	1.792	1.869*	370.6	361.6*	213.1	207.7*
June	1.950	1.940	1.254	1.256	1.796	1.768	372.8	364.8	213.8	209.1
July	1.948	1.936	1.270	1.275	1.813	1.793	374.0	365.5	213.7	208.9
August	1.923	1.930	1.281	1.284	1.756	1.784	376.0	364.3	214.1	207.6
September	1.874	1.878	1.268	1.260	1.721	1.692	376.9	364.7	214.0	207.1
October	1.882	1.864	1.260	1.253	1.695	1.713	378.5	365.3	214.3	206.9
November	1.875	1.832	1.258	1.226	1.704	1.686	379.0	365.2	213.9	206.3
December	1.847	1.794	1.235	1.205	1.688	1.682	379.2	363.9	213.3	205.0
January 1987	1.761	1.761	1.172	1.193	1.615	1.653	378.9	364.5	212.5	204.8
February	1.719	1.763	1.146	1.205	1.567	1.622	378.5	363.9	211.7	204.0
March	1.698	1.737	1.141	1.195	1.528	1.587	377.6	364.9	210.5	203.9
April	1.694	1.707	1.129	1.167	1.533	1.565	375.6	364.7	208.8	203.2
May	1.698	1.664	1.122	1.136	1.539	1.516	374.0	364.1	207.2	202.4
June	1.691	1.665	1.127	1.143	1.552	1.493	371.8	362.6	205.4	201.0

	Non-Residential		Public Construction		Residential Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1986	135.4	135.0	68.1	68.4	152.6	151.7
February	137.8	135.0	66.9	68.6	155.8	155.1
March	138.6	129.3	67.3	69.0	161.3	155.2
April	139.1	127.7	67.6	69.4	161.7	155.5
May	139.6	133.7*	68.0	69.2*	136.0	159.6*
June	140.2	135.2	68.2	69.5	164.4	160.1
July	140.0	136.0	68.5	69.2	165.5	160.3
August	140.3	136.3	68.9	69.7	166.8	158.3
September	139.7	137.1	69.3	70.1	167.9	157.5
October	140.5	137.6	69.8	70.5	168.2	157.2
November	140.9	138.2	70.1	70.9	168.0	156.1
December	141.0	138.5	70.5	70.6	167.7	154.8
January 1987	141.2	138.9	70.7	71.2	167.0	154.4
February	141.3	138.5	70.9	71.6	166.3	153.8
March	141.1	138.6	70.9	72.1	165.6	154.2
April	141.2	138.0	71.2	72.3	163.2	154.4
May	141.4	137.5	71.4	72.5	161.2	154.1
June	141.1	137.7	71.4	72.9	159.3	152.0

Fore. = May Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

FINANCIAL MARKETS

	Monetary Base		M1		M2		Federal Funds		T-Bills (6 Mos.)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1986	235.8	235.8	627.2	627.2	2568.5	2569.1	8.14	8.14	7.16	7.16
February	237.8	237.8	631.0	631.1	2576.3	2576.8	7.86	7.86	7.11	7.11
March	239.0	239.0	638.4	638.4	2590.4	2591.3	7.48	7.48	6.57	6.57
April	240.2	239.8	642.3	646.1	2607.4	2621.6	7.07	6.99	6.33	6.08
May	241.2	241.9	645.3	656.0*	2622.3	2642.5*	7.04	6.83*	6.22	6.25*
June	242.3	242.7*	648.4	659.7	2637.1	2660.0	6.99	6.85	6.12	6.27
July	244.2	244.0	653.3	662.5	2653.2	2674.0	6.89	6.96	6.23	6.41
August	245.7	245.3	658.0	664.8	2675.1	2687.4	6.78	7.13	6.35	6.57
September	247.2	246.7	662.7	668.6	2697.0	2706.2	6.95	7.25	6.46	6.65
October	248.8	248.3	664.5	671.7	2710.2	2722.4	7.26	7.38	6.59	6.69
November	250.1	249.8	666.0	675.0	2720.1	2738.7	7.32	7.50	6.68	6.73
December	251.4	251.2	667.6	678.2	2730.0	2755.1	7.38	7.52	6.77	6.78
January 1987	252.6	252.5	672.0	681.2	2749.8	2771.6	7.42	7.53	6.85	6.79
February	253.7	253.8	676.9	684.5	2769.2	2788.2	7.46	7.48	6.83	6.71
March	254.9	255.0	681.8	687.2	2782.6	2804.9	7.50	7.45	6.78	6.68
April	256.3	256.2	682.5	689.2	2796.6	2818.9	7.32	7.32	6.65	6.63
May	257.4	257.3	683.4	692.1	2809.2	2835.8	7.20	7.36	6.59	6.65
June	258.5	258.5	684.2	695.1	2822.1	2852.8	7.11	7.28	6.53	6.57

	Aaa (Seasoned)		Municipals (Bond Buyer)		(3 Month) Commercial Paper		90 Day CD's		Prime Rate	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1986	10.05	10.05	8.08	8.08	7.71	7.71	7.82	7.82	9.50	9.50
February	9.67	9.67	7.44	7.44	7.63	7.63	7.69	7.69	9.50	9.50
March	9.00	9.00	7.08	7.08	7.20	7.20	7.24	7.24	9.10	9.10
April	8.74	8.79	7.28	7.20	6.98	6.60	7.06	6.60	8.69	8.83
May	8.89	9.06*	7.47	7.56*	6.95	6.80*	7.02	6.83*	8.50	8.50
June	8.75	9.13	7.31	7.72	6.98	6.85	7.05	6.91	8.50	8.50
July	8.98	9.27	7.59	7.86	6.85	7.03	6.93	7.15	8.50	8.50
August	9.07	9.35	7.66	7.93	6.80	7.17	6.89	7.22	8.50	8.50
September	9.05	9.42	7.63	8.03	6.96	7.31	7.11	7.39	8.50	8.50
October	9.26	9.61	7.82	8.19	7.33	7.40	7.42	7.53	8.67	8.89
November	9.35	9.65	7.89	8.20	7.38	7.53	7.50	7.65	9.00	9.00
December	9.41	9.60	7.92	8.16	7.45	7.55	7.58	7.69	9.00	9.00
January 1987	9.43	9.57	7.95	8.14	7.48	7.50	7.56	7.58	9.00	9.00
February	9.39	9.53	7.83	8.06	7.52	7.42	7.63	7.53	9.00	9.00
March	9.35	9.52	7.78	8.04	7.46	7.40	7.60	7.49	9.00	9.00
April	9.29	9.46	7.66	7.95	7.25	7.25	7.41	7.39	9.00	9.00
May	9.26	9.37	7.62	7.87	7.16	7.26	7.36	7.38	9.00	9.00
June	9.28	9.36	7.65	7.85	7.07	7.22	7.21	7.35	9.00	9.00

Fore. = May Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

Georgia State University

a unit of the university system of georgia

university plaza
atlanta, georgia 30303-3083

college of business administration
economic forecasting center
404/658-3282

MONTHLY PROJECTIONS

June 1986

Dr. Donald Ratajczak, Director
For Release: July 15, 1986

FOREIGN TRADE NOT YET CONTRIBUTING TO ECONOMIC GROWTH

Since February 27, 1985, the trade-weighted value of the dollar has fallen by nearly 35%. However, there is scant evidence that prices of imported goods have changed to reflect these currency differences. Automobile import prices are up 7.4% over the past year, but the prices of consumer nondurable goods are up only 3%. More importantly, industrial materials excluding petroleum actually show a 4% decline in import prices. Apparently, importers are protecting their market shares by accepting significant reductions in their profit margins. Also, the trade-weighted currency index may overstate the dollar's decline as a result of an increase in the percentage of imported goods that is evaluated more closely to dollar movements.

A failure to dislodge imports is not the only problem facing the American economy. Exports also are not showing any dramatic rebound. The problem associated with exports is the failure of other industrialized countries to maintain vigorous growth. Both Germany and Japan continue to have export driven economies despite the enormous surpluses both countries are generating on their trade accounts. Unfortunately, the falling dollar has marginally reduced import competitiveness into the United States while a continuation of large American trade deficits continue to restrain economic growth here. In addition, the collapse in petroleum prices has eliminated the Middle East as an attractive target for German exports. Thus, both Japan and Germany experienced economic contraction in their first quarters. Growth is expected to resume in both countries and both countries may generate 3% real growth when the year's results are tallied, but world trade probably will be slowing to only a 3% real rate of growth in 1986 and in 1987. Without policies to stimulate domestic economies throughout the industrialized world, world growth could slow to less than 3% in 1987.

This slowing in world growth and the failure of the dollar's decline to translate into reduced import penetration has resulted in a downward revision in U. S. economic growth for the next year. Of course, the dollar's decline also has not been converted into as much inflation as previously anticipated. Therefore, inflationary pressures also have been scaled downward in our projections for the next year.

Adding to reduced inflation is more substantial production of oil by OPEC than originally anticipated. In concluding that crude petroleum prices would stabilize near \$15 per barrel in 1986, we presumed that OPEC production would remain below 18 million barrels per day. In fact, Middle East reports suggest that June production was 19.5 million barrels and early reports for July indicate that Saudi Arabia will be raising its production to more than five million barrels per day. This suggests that OPEC production could approach 20 million barrels per day during the summer months. As a result of this increased production, the equilibrium price for petroleum may only be slightly more than \$12 per barrel. This projection helps the dollar value of trade deficits, but does very little to alter the physical volume of trade flows. This downward revision in oil prices also leads to lower projections for inflationary pressures than previously anticipated. (However, a surge in construction costs early in 1986 is more than offsetting increased benefits from lower oil prices as measured by the GNP deflator.) Downward revisions in oil prices also will lead to greater real consumer spending than originally projected. Of course, it will also lead to greater disruptions in the oil patch and probably will prevent any rebound in shipments and orders of nondefense capital goods. On the whole, however, a downward revision in oil prices is favorable for economic conditions in the United States.

Nevertheless, relatively sluggish economic gains ahead remain likely. Of greatest concern at the present time, aside from continuing trade problems, is the adverse impact upon 1987 activity from tax reform proposals. The tax reform package will severely curtail the near-term attractiveness of real estate investments. Until those investments replace tax advantages with increased rental incomes, the desire to add to real estate inventory will be sharply curtailed. However, improved rental rates will be impossible until vacancy rates have been significantly reduced. As a result, construction is expected to fall continuously through the second half of 1986 and well into 1987. Weakness is expected to be most pronounced for nonresidential construction, but significant weakness in multi-family units also should develop.

In addition to the tax reform-induced weakness in construction, the increased tax burdens on earnings from some capital probably will forestall any significant rebound in capital spending. Although a modest growth in orders for capital goods and for shipments is anticipated during the second half of 1986, orders and shipments once again should be trending downward in 1987.

Several commentators have maintained that savings could suffer and consumption would be benefitted because of the shift in tax burdens from households to the corporate sector. Certainly, changes in investment tax credits and less generous depreciation guidelines will have an adverse effect upon capital spending. However, a significant portion of the increased corporate tax burden is derived by a more sweeping minimum tax on the corporate sector. Most economic studies suggest that capital will not pay the increased corporate taxes other than those directly effecting the tax treatment of capital purchases. Rather, workers and customers probably will pay those taxes. Because workers also will be receiving lower marginal tax rates, they are most likely to shoulder most of the increased corporate tax burdens. (This means that the wage recipients probably will receive lower wage increases than would have occurred in the absence of tax changes.) Thus, before-tax wages should slow relative to GNP expansion and the household sector should receive about the same after-tax purchasing power as before the tax changes. Similarly, the increased tax burdens on corporations should be offset by reduced labor cost burdens leading to

no appreciable change in the corporate cost structure. Thus, claims that tax reform would add to inflation and increase consumer activity do not appear to be warranted by longstanding analysis on the incidence of corporate taxes.

On the other hand, changes in the investment tax credit certainly alters the timing of capital accumulation. This explains why capital spending is not expected to appreciate in 1987. Also, the timing of tax changes leads to a tax increase in 1987 followed by tax reductions in 1988 and 1989. To a great extent, these tax shifts should merely alter the savings behavior of the household sector as they contemplate reduced tax burdens ahead. However, some households probably are suffering from a liquidity constraint and, therefore, will curtail spending when their 1987 increased tax burdens become due early in 1988.

Although tax reform generates transitional problems that will cause a 2-4 year construction lull, a temporary slowing in capital accumulation, and even some hesitancy in consumer spending, the longer-term aspects of the tax reform program are favorable.

First, while the tax treatment of capital earnings is increased, the tax treatment of earnings generated by labor is reduced. Labor intensive industries will benefit from these tax changes while most of the suffering in the capital sector will be borne by those who accepted underutilization of capital because substantial tax benefits were being derived. Therefore, incentives provided to labor should more than offset any disincentives created by the tighter tax treatment of capital. Long-term economic growth should benefit.

Second, reduced spending for underutilized capital should combine with increased savings incentives in the household sector, because the after-tax returns on marginal savings should be substantially increased, to reduce interest rates. While total capital accumulation will grow more slowly, productive capital will be encouraged by relatively lower interest rates.

Despite longer-term favorable consequences from tax changes, one other transitional problem encompassed in the tax proposal is the change in the capital gains provision in the Senate version from 20% to 27%. While the elimination of a capital gains definition greatly simplifies tax codification, many investors with previously accumulated capital appreciation may choose to sell their holdings in 1986, before the tax change on capital gains is implemented. When this is combined with the initial economy-slowng effects of the tax reform transition, a significant decline in stock market values appears to be likely before the end of this year.

Quarterly Profile of GNP

	<u>1986-1</u>	<u>1986-2</u>	<u>1986-3</u>	<u>1986-4</u>	<u>1987-1</u>	<u>1987-2</u>	<u>1986 Annual</u>
Real:	2.9	0.7	2.7	3.0	1.9	1.4	2.0
Price:	2.9	1.3	2.9	3.5	4.3	4.2	2.7
Nominal:	5.7	2.1	5.7	6.6	6.3	5.5	4.7

Monthly Statistical Highlights for June 1986

Personal income 0.0%; savings rate 3.7%; personal consumption +0.5%; retail sales +0.4%; housing starts -2.3%; housing permits -2.2%; construction expenditures -0.1%; business inventories -0.3%; orders for durable goods -0.2%; orders for nondefense capital goods +1.4%; industrial production -0.2%; CPI +0.4%; consumption deflator +0.3%; leading indicators -0.1%; real GNP +1.7%; M1 +15.0%; M2 +9.6%.

Monthly Statistical Highlights for July 1986

Payroll employment +368,000; index of hours worked +0.4%; household employment +171,000; civilian unemployment rate 7.1%; personal income +0.6%; savings rate 3.6%; personal consumption +0.7%; retail sales +0.5%; auto sales 11.1 million; housing starts -1.9%; housing permits -1.3%; construction expenditures -0.5%; business inventories +0.1%; orders for durable goods +1.0%; orders for nondefense capital goods +0.6%; industrial production +0.2%; CPI +0.2%; PPI -0.1%; consumption deflator +0.2%; leading indicators -0.3%; real GNP +3.0%; M1 +11.4%; M2 +7.3%.

COMMENTARY

Employment - A significant downward revision in the index of hours worked explains the discrepancy that developed during the first quarter between productivity measures and the previously announced employment statistics. Payroll employment also was revised downward modestly. In general, the payroll report for June shows weakness, although several factors significantly diminished the significance of the report. First, a strike by AT&T workers caused a 170,000 reduction in payroll employment during June. Second, the survey arrived unusually early in the month, causing less than a complete month between surveys. In July, the survey will be the latest it possibly can be, leading to a greater-than-normal gap between survey periods. Third, seasonals are notoriously volatile in June, especially when the survey period deviates from mid month. These distortions are the major reasons why a significant rebound is expected both in the index of hours worked and in payroll employment during July.

Nevertheless, the employment situation was relatively weak, with manufacturing activity showing a modest decline even after the AT&T manufacturing facilities are taken out of the statistics. Certainly, only 44% of manufacturing industries registering job increases cannot be explained by strike activity. On the other hand, a surge in the hourly earnings index probably is the result of distortions that strike activity normally creates in that measure.

Personal Income & Outlays - Substantial farm subsidies continued to aid personal income in May, although the subsidies were sharply reduced from April. In June, farm subsidies should be sharply curtailed, leading to another relatively flat

report for personal income. Wage income should rise more significantly than in May even after strike activity removes some wages.

Strong auto sales were largely responsible for the sharp rebound in durable purchases during May. Auto sales remained strong, although they weakened slightly in June. On the other hand, price increases for gasoline should be reflected in more significant gains for nondurables until oil prices once again soften in August.

Construction - Favorable weather apparently increased public construction activity in May. More favorable treatment of tax exempt bonds by the Senate version of tax reform also may have encouraged some municipalities to once again finance public projects. The \$3.9 billion rebound in public construction activity during May should not be sustained in the next two months. Similarly, the collapse in nonresidential construction appears to be sharper than even relatively unfavorable economic conditions justify. Although some declines have occurred in office buildings, the weakness has also been in industrial construction, where excess product is not a factor.

Weakness in rental property apparently reflects concern about the impact that tax changes will have upon that market. These concerns appear to be justified and should lead to significant declines in rental starts in the months ahead. Single-family activity apparently is stalled by bottlenecks created by refinancing activity during the spring. These bottlenecks slowly are being resolved and should lead to a continuation of relatively robust single-family activity through the remainder of this year.

While construction was booming early in the year, construction costs began to accelerate. Cost increases in April and May were especially dramatic. More modest price increases are expected in the months ahead. Nevertheless, the construction component of the GNP deflator should be adding inflationary pressures for the remainder of this year.

Business Activity - Manufacturers continued to sharply liquidate inventories in May, when their inventories fell 0.3%. Inventory liquidations are expected to continue into July followed by some inventory rebuilding. Although manufacturers have constrained their inventories, retailers have had more difficulty controlling their stockpiles. The major culprit is the auto industry, which significantly added to inventories during April. However, a return of relatively brisk sales along with some moderation in production is beginning to diminish those retail inventories.

Aircraft shipments have dramatically distorted shipments of manufactured goods in recent months. Also, price changes for petroleum products have presented the appearance of greater weakness in manufacturing shipments than actually occurred. Nevertheless, shipments of nondefense capital goods have remained sluggish. A modest rebound is anticipated in the months ahead, but relatively low capacity utilization should forestall any significant rebound in capital goods activity.

Prices - Overproduction by OPEC has necessitated a more substantial downward revision in prices for industrial commodities and finished goods than originally projected. There also will be a significant decline in prices of consumer nondurables, although some of this petroleum price weakness will be offset by higher prices for meats than originally projected. Dollar weakness has

generated higher prices for imports, leading to higher prices for domestically produced autos. On the other hand, sharp increases in housing costs early in the year should not persist. An overhang of rental inventories should restrain some price gains into next year.

Miscellaneous - According to our estimates, real GNP declined sharply in May and only gradually rebounded in June. This weakness was partially the result of inventory liquidations, and therefore will be followed by some strength late in 1986. However, some of the weakness was also caused by higher trade deficits than had been anticipated. Although our estimates of trade balances shows a modest decline relative to forecast, this is solely the results of more substantial oil price declines that had been originally projected. In fact, after adjustment for petroleum price movements, the real value of the merchandise trade balance is more negative than originally projected. This is a major factor in generating more substantial weakness into 1987 than previously expected.

FINANCIAL MARKETS

Lower inflation as a result of greater oil price weakness than originally projected and more sluggish economic activity as a result of less response in the trade balances than expected led to reduced interest rate pressures. The Federal Reserve followed this weakness by aggressively moving the discount rate downward and accommodating this lower discount rate with increased reserves. This action apparently was taken as a result of concern that other industrialized nations were not increasing their purchases of American goods.

However, an analysis by sector suggests that interest rates would have been declining anyway once oil inventories again began liquidations. These liquidations reappeared in the middle of June and should continue through the end of July. Some inventory rebuilding may then resurface late in August and early September, leading to some upward interest rate pressures at that time. The Federal Reserve is expected to offset any of these upward pressures by accepting more rapid growth in reserve expansion than originally expected.

Unfortunately, the rapid growth in M1 had prevented the Federal Reserve from following an aggressive monetary policy. It is apparent that M1 growth is in the checkable deposits, where relatively fixed yields are becoming increasingly attractive as short-term interest rates decline. This has led to a dramatic accumulation of checkable deposits for savings purposes. In effect, the most traditional measure of money is not performing as money. Therefore, the Federal Reserve is correct in understating the importance of M1, although it might make a serious error if it also ignores other monetary aggregates.

Equity Markets

Fears about equity sales because of changes in the capital gains rate apparently have accelerated the anticipated second half stock market correction. Those investors holding substantial capital gains and contemplating a rise in the tax rate from 20% to 27% have been unwinding their positions. This unwinding was intensified when rumors circulated suggesting that the effective date for capital gains could be changed from January 1, 1987 to the beginning date for the conference committee on tax reform. Our feeling is that this correction could carry the stock market to the vicinity of 1650. Normally, such a decline would unwind over several quarters, but intensified selling by investors with substantial gains may cause this adjustment to occur before the end of 1986.

Some analysts have maintained that such selling would not have an appreciable impact upon the stock market because these investors would merely buy other issues. In fact, however, they would probably initially move to cash until they decided their next portfolio strategy. If enough people moved to cash at the same time, equity values would fall substantially. Then, program selling would accentuate the price weakness. After having garnered their capital gains at lower tax rates, investors would remain in cash until the correction subsided. This suggests that early in 1987 a significant rebound in stock market values could materialize as this cash becomes redeployed in other equity investments. However, falling equity values for the remainder of 1986 now appears to be likely.

EMPLOYMENT

	Payroll Employment		Index of Hours Worked		Household Civilian Employment		Civilian Unemployment Rate		Hourly Earnings Index	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1986	99496	99296	119.1	117.8	108955	108955	6.7	6.7	167.4	167.3
February	99649	99429	118.5	117.5	108561	108561	7.2	7.3	168.4	168.2
March	99841	99484	118.9	117.4	108788	108788	7.2	7.2	168.8	168.5
April	100029	99783	119.2	117.8	109024	108892	7.1	7.1	169.2	168.4
May	100296	99908	119.5	117.7	109265	109110	7.0	7.3	169.3	168.6
June	100563	99819	119.8	117.5	109512	109673	7.0	7.1	169.5	169.4
July	100778	100189*	120.1	118.0*	109773	109844*	6.9	7.1*	170.2	169.8*
August	100972	100324	120.5	118.2	109975	109996	6.8	7.0	170.8	170.3
September	101065	100506	121.0	118.4	110178	110209	6.7	7.0	171.4	170.9
October	101397	100684	121.2	118.6	110418	110392	6.7	6.9	171.9	171.2
November	101649	100829	121.4	118.7	110753	110555	6.6	6.9	172.5	171.6
December	102015	100966	121.6	118.8	111130	110709	6.5	6.9	173.1	172.1
January 1987	102098	101123	121.8	119.0	111275	110877	6.5	6.9	173.5	172.6
February	102197	101268	121.9	119.2	111356	111031	6.5	6.9	173.9	173.2
March	102295	101406	122.0	119.3	111439	111161	6.4	7.0	174.4	173.7
April	102468	101542	122.2	119.5	111694	111324	6.4	7.0	174.9	174.3
May	102705	101703	122.5	119.6	111918	111495	6.3	7.0	175.4	174.9
June	102921	101887	122.8	119.8	112142	111723	6.3	7.0	176.0	175.5

PERSONAL INCOME

	Personal Income		Wage & Salary		Personal Savings		Disposable Income		Personal Outlays	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1986	3.387	3.385	2.027	2.027	124.7	122.9	2.882	2.881	2.758	2.758
February	3.401	3.400	2.034	2.034	125.7	124.3	2.896	2.896	2.771	2.771
March	3.407	3.407	2.044	2.045	122.9	130.9	2.904	2.904	2.781	2.773
April	3.432	3.449	2.052	2.048	127.8	157.4	2.926	2.944	2.788	2.786
May	3.429	3.445	2.062	2.051	127.3	125.4	2.921	2.938	2.794	2.812
June	3.435	3.445*	2.073	2.059*	124.0	109.8*	2.928	2.935*	2.805	2.825*
July	3.459	3.464	2.081	2.074	121.9	106.7	2.944	2.951	2.822	2.844
August	3.482	3.483	2.092	2.086	121.7	116.5	2.962	2.966	2.841	2.850
September	3.506	3.501	2.103	2.098	121.7	117.6	2.981	2.981	2.860	2.863
October	3.526	3.518	2.113	2.107	118.7	118.2	2.996	2.995	2.878	2.877
November	3.547	3.531	2.125	2.115	120.7	111.9	3.012	3.005	2.892	2.893
December	3.569	3.550	2.137	2.125	123.0	107.9	3.029	3.020	2.906	2.912
January 1987	3.575	3.563	2.148	2.136	120.7	112.1	3.042	3.036	2.922	2.924
February	3.598	3.583	2.158	2.149	120.6	119.7	3.061	3.058	2.940	2.938
March	3.633	3.600	2.168	2.158	132.4	118.7	3.090	3.072	2.958	2.953
April	3.640	3.621	2.179	2.171	116.6	121.8	3.094	3.090	2.977	2.968
May	3.649	3.638	2.187	2.181	104.8	108.4	3.098	3.088	2.993	2.980
June	3.659	3.662	2.196	2.194	96.7	114.3	3.104	3.109	3.009	2.995

Fore. = May Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

CONSTRUCTION

	Housing Starts		Single Family Starts		Housing Permits		Construction Expenditures (Current)		Construction Expenditures (Real)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1986	2.034	2.034	1.335	1.335	1.899	1.861	356.1	373.4	206.9	337.7
February	1.997	2.001	1.204	1.202	1.803	1.808	360.5	373.9	209.2	338.3
March	1.949	1.960	1.212	1.221	1.846	1.834	367.2	368.0	212.5	331.8
April	1.966	2.039	1.256	1.262	1.833	1.885	368.4	371.6	212.6	331.8
May	1.940	1.888	1.237	1.262	1.792	1.785	370.6	374.7	213.1	331.6
June	1.950	1.844*	1.254	1.234*	1.796	1.745*	372.8	374.3*	213.8	329.5*
July	1.948	1.809	1.270	1.226	1.813	1.723	374.0	372.4	213.7	326.1
August	1.923	1.839	1.281	1.257	1.756	1.667	376.0	368.9	214.1	321.6
September	1.874	1.853	1.268	1.289	1.721	1.652	376.9	369.5	214.0	320.7
October	1.882	1.807	1.260	1.251	1.695	1.664	378.5	369.6	214.3	319.4
November	1.875	1.806	1.258	1.234	1.704	1.551	379.0	369.3	213.9	318.1
December	1.847	1.728	1.235	1.186	1.688	1.526	379.2	368.8	213.3	316.6
January 1987	1.761	1.702	1.172	1.169	1.615	1.483	378.9	364.6	212.5	311.9
February	1.719	1.640	1.146	1.124	1.567	1.480	378.5	363.4	211.7	309.5
March	1.698	1.665	1.141	1.143	1.528	1.496	377.6	360.3	210.5	305.9
April	1.694	1.686	1.129	1.162	1.533	1.495	375.6	359.0	208.8	304.0
May	1.698	1.673	1.122	1.155	1.539	1.513	374.0	359.3	207.2	303.5
June	1.691	1.649	1.127	1.127	1.552	1.521	371.8	361.5	205.4	304.5

	Non-Residential		Public Construction		Residential Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1986	135.4	142.0	68.1	68.0	152.6	163.4
February	137.8	141.0	66.9	68.3	155.8	164.7
March	138.6	133.3	67.3	69.2	161.3	165.6
April	139.1	133.4	67.6	70.5	161.7	167.8
May	139.6	130.5	68.0	74.4	136.0	169.8
June	140.2	130.7*	68.2	73.7*	164.4	169.9*
July	140.0	129.8	68.5	73.9	165.5	168.7
August	140.3	129.5	68.9	74.2	166.8	165.2
September	139.7	129.7	69.3	74.0	167.9	165.8
October	140.5	129.2	69.8	73.6	168.2	166.8
November	140.9	128.6	70.1	74.1	168.0	166.6
December	141.0	128.2	70.5	74.4	167.7	166.2
January 1987	141.2	127.5	70.7	73.5	167.0	163.6
February	141.3	127.3	70.9	73.8	166.3	162.3
March	141.1	127.0	70.9	74.4	165.6	158.9
April	141.2	126.1	71.2	74.8	163.2	158.1
May	141.4	125.7	71.4	75.2	161.2	158.4
June	141.1	126.2	71.4	75.5	159.3	159.8

Fore. = May Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

BUSINESS ACTIVITY

	Manufacturers' Inventories		Durable Goods Orders		Non-Defense Capital Goods Orders		Non-Defense Capital Shipments	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1986	280.4	280.4	108.46	108.19	24.55	24.29	25.60	25.35
February	279.5	279.2	107.82	107.55	28.91	28.64	26.86	26.56
March	278.7	279.6	105.07	104.68	27.02	26.54	27.82	27.30
April	278.2	279.4	105.09	103.75	27.20	26.18	27.40	27.36
May	279.0	278.4	106.01	103.64	27.63	26.28	27.58	26.64
June	280.3	277.8*	105.84	103.43*	27.85	26.65*	27.76	26.78*
July	281.1	277.5	107.13	104.46	28.46	26.82	27.85	26.93
August	282.2	278.3	106.67	104.79	28.40	26.93	27.97	27.05
September	283.2	279.2	108.23	105.13	28.86	27.11	28.09	27.21
October	284.4	280.1	108.84	104.83	29.16	26.92	28.35	27.15
November	286.3	280.9	109.28	104.74	29.33	26.83	28.63	27.04
December	287.4	282.3	108.89	105.93	29.30	26.97	28.91	27.11
January 1987	288.8	283.4	108.37	106.27	29.21	27.13	29.05	27.20
February	290.3	285.2	109.52	106.35	29.34	27.24	29.11	27.34
March	292.5	286.9	109.76	106.91	29.22	27.39	29.17	27.53
April	294.9	288.1	108.83	106.95	29.12	27.35	29.35	27.68
May	296.2	289.8	108.72	106.53	29.18	27.24	29.48	27.55
June	298.0	290.7	108.85	106.28	29.30	27.11	29.61	27.39

	Business Inventories		Defense Shipments		Industrial Production		Capacity Utilization	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1986	585.0	585.0	7.03	7.03	126.6	126.7	80.7	80.8
February	585.1	585.2	7.58	7.58	125.7	125.7	80.0	80.0
March	585.8	587.7	7.27	7.08	125.1	124.9	79.4	79.3
April	587.0	590.2	7.40	7.33	125.5	125.1	79.5	79.3
May	588.1	588.4*	7.49	7.52	125.8	124.3	79.5	78.6
June	589.9	586.9	7.59	7.59*	126.4	124.1	79.7	78.4*
July	591.2	587.3	7.68	7.71	127.2	124.4	80.0	78.5
August	593.5	588.8	7.85	7.84	127.8	124.7	80.2	78.6
September	595.7	590.6	8.05	7.96	128.4	125.0	80.4	78.7
October	598.2	592.2	8.01	7.92	128.6	125.2	80.4	78.7
November	600.3	594.0	8.07	8.03	128.8	125.3	80.4	78.6
December	602.4	596.2	8.18	8.15	129.0	125.5	80.3	78.6
January 1987	605.8	598.5	8.25	8.26	128.9	125.7	80.1	78.6
February	609.9	600.9	8.33	8.32	129.1	126.0	80.1	78.7
March	613.9	603.3	8.40	8.40	129.2	126.2	80.0	78.7
April	617.1	607.2	8.38	8.43	128.8	126.3	79.7	78.6
May	620.8	609.3	8.45	8.49	128.5	126.3	79.4	78.4
June	623.3	611.9	8.52	8.53	128.2	126.2	79.1	78.1

Fore. = May Forecast

C.E. = Current Expectations

* = This item and those beyond it are expectations.

PRICES

	CPI-U		PPI Finished Goods		PPI-Industrial Commodities		Estimated GNP Deflator	
	(seasonally adjusted)		(seasonally adjusted)		(unadjusted)			
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1986	329.0	329.0	296.3	296.3	324.0	323.8	113.9	113.9
February	327.7	327.7	291.7	291.7	319.4	319.4	113.8	113.8
March	326.4	326.3	288.6	288.6	314.0	314.0	113.4	113.7
April	325.5	325.4	287.1	286.8	209.6	331.3	113.6	113.8
May	325.9	326.1	287.8	288.5	310.9	311.7	113.9	114.2
June	326.6	327.4*	288.5	288.5*	312.3	311.1*	114.2	114.5
July	327.7	328.0	290.3	288.0	313.4	310.6	114.4	114.8
August	328.8	329.2	291.0	288.2	314.7	311.3	114.7	115.0
September	330.0	330.3	291.7	286.9	331.6	309.2	115.0	115.2
October	331.0	331.4	292.3	289.5	315.8	312.2	115.4	115.6
November	331.9	332.5	293.5	290.3	316.1	313.0	115.8	116.0
December	332.8	333.9	294.5	291.5	316.5	314.6	116.2	116.4
January 1987	334.3	335.0	295.2	292.5	317.0	315.5	116.7	116.8
February	335.9	336.0	295.9	293.1	317.8	316.3	117.1	117.2
March	337.5	337.1	296.6	293.7	318.5	317.0	117.5	117.7
April	338.6	338.2	297.3	294.3	319.4	317.8	117.9	118.1
May	339.7	339.3	298.1	294.9	320.3	318.6	118.3	118.4
June	340.6	340.7	298.9	296.1	321.2	319.3	118.7	118.8

	Consumption Deflator		Consumer Durables		Consumer Nondurables		Consumer Services		Implicit Construction Deflator	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1986	113.8	113.8	104.9	104.9	109.8	109.8	119.5	119.6	172.1	110.6
February	113.3	113.4	105.0	105.2	108.1	108.0	119.8	120.0	172.3	110.6
March	112.9	113.0	105.0	104.7	106.8	106.8	120.3	120.3	172.8	110.9
April	112.8	113.0	105.2	105.0	106.1	106.0	120.6	120.8	173.3	112.0
May	113.2	113.3*	105.3	105.3*	106.0	106.2*	121.0	121.2*	173.9	113.0
June	113.7	113.6	105.5	105.5	106.2	106.4	121.4	121.6	174.4	113.6*
July	114.0	113.8	105.6	105.7	106.4	106.5	122.0	122.0	175.0	114.2
August	114.2	114.2	105.7	106.0	106.5	106.6	122.7	122.5	175.6	114.7
September	114.4	114.6	105.8	106.2	106.7	107.0	123.4	123.0	176.1	115.2
October	114.8	115.0	106.1	106.5	107.1	107.3	123.8	123.5	176.6	115.7
November	115.4	115.4	106.4	106.8	107.6	107.6	124.1	124.1	177.2	116.1
December	116.0	115.9	106.7	107.0	108.1	108.0	124.5	124.6	177.8	116.5
January 1987	116.3	116.3	107.0	107.3	108.4	108.3	125.0	125.1	178.3	116.9
February	116.7	116.7	107.3	107.5	108.7	108.6	125.6	125.7	178.8	117.4
March	117.1	117.1	107.6	107.8	109.0	109.0	126.1	126.2	179.4	117.8
April	117.5	117.5	107.9	108.1	108.9	109.2	126.7	126.8	179.9	118.1
May	118.0	117.9	108.2	108.4	109.0	109.3	127.3	127.4	180.5	118.4
June	118.5	118.4	108.5	108.8	109.2	109.6	128.0	128.0	181.0	118.7

Fore. = May Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

MISCELLANEOUS

	Merchandise		Leading		Estimated		Estimated		IVA	
	Trade Balance		Indicators		GNP		GNP (1982 \$)		(annual rate)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1986	-14.93	-15.00	174.1	173.4	4116	4115	3614	3613	0.8	1.6
February	-14.21	-11.16	175.4	175.2	4115	4115	3616	3616	13.3	14.8
March	-14.03	-13.06	176.4	176.2	4118	4117	3631	3621	27.9	36.4
April	-12.73	-14.02	177.3	178.5	4127	4128	3633	3627	30.3	34.8
May	-12.52	-14.27p	178.2	178.8	4156	4133	3649	3619	14.2	23.5
June	-12.32	-12.46*	178.4	178.6*	4203	4149	3680	3624	6.2	17.2
July	-11.96	-12.62	178.2	178.2	4221	4171	3690	3633	1.6	15.5
August	-12.06	-12.18	177.5	178.5	4241	4194	3697	3647	-3.5	13.9
September	-12.20	-11.93	178.0	178.9	4262	4219	3706	3662	-8.3	10.4
October	-12.15	-11.76	178.3	178.4	4288	4235	3716	3663	-8.0	7.3
November	-12.03	-11.52	178.7	178.2	4315	4263	3726	3675	-7.2	1.2
December	-11.90	-11.75	178.3	178.5	4342	4288	3737	3684	-6.5	-1.5
January 1987	-11.95	-11.63	177.2	178.9	4363	4307	3739	3688	-8.6	-3.6
February	-11.91	-11.46	177.3	178.8	4385	4328	3745	3693	-10.9	-7.4
March	-11.86	-11.21	176.8	179.3	4406	4347	3750	3693	-12.5	-5.6
April	-11.80	-11.57	176.1	179.1	4424	4374	3752	3704	-12.1	-8.5
May	-11.72	-11.15	175.5	178.8	4440	4384	3753	3703	-11.6	-9.2
June	-11.64	-11.02	175.3	178.5	4455	4400	3753	3704	-11.4	-9.5

Fore. = May Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

FINANCIAL MARKETS

	Monetary Base		M1		M2		Federal Funds		T-Bills (6 Mos.)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1986	235.8	235.7	627.2	627.2	2568.5	2569.1	8.14	8.14	7.16	7.16
February	237.8	237.7	631.0	631.1	2576.3	2576.8	7.86	7.86	7.11	7.11
March	239.0	238.7	638.4	638.4	2590.4	2591.3	7.48	7.48	6.57	6.57
April	240.2	239.9	642.3	646.1	2607.4	2621.6	7.07	6.99	6.33	6.08
May	241.2	242.3	645.3	658.6	2622.3	2647.0	7.04	6.85	6.22	6.19
June	242.3	244.2	648.4	666.3	2637.1	2667.3	6.99	6.88*	6.12	6.25*
July	244.2	245.4*	653.3	672.3*	2653.2	2683.0*	6.89	6.45	6.23	5.92
August	245.7	246.6	658.0	676.9	2675.1	2701.1	6.78	6.37	6.35	5.78
September	247.2	247.5	662.7	679.6	2697.0	2717.0	6.95	6.42	6.46	5.89
October	248.8	248.5	664.5	681.6	2710.2	2733.0	7.26	6.29	6.59	5.76
November	250.1	249.7	666.0	684.7	2720.1	2749.1	7.32	6.43	6.68	5.94
December	251.4	251.0	667.6	687.7	2730.0	2762.6	7.38	6.48	6.77	6.03
January 1987	252.6	252.3	672.0	691.3	2749.8	2778.9	7.42	6.53	6.85	6.17
February	253.7	253.6	676.9	695.6	2769.2	2798.1	7.46	6.62	6.83	6.21
March	254.9	254.7	681.8	697.9	2782.6	2814.6	7.50	6.53	6.78	6.08
April	256.3	255.6	682.5	699.3	2796.6	2828.4	7.32	6.57	6.65	6.12
May	257.4	256.6	683.4	703.3	2809.2	2844.3	7.20	6.39	6.59	6.03
June	258.5	258.1	684.2	707.5	2822.1	2861.0	7.11	6.35	6.53	5.92

	Aaa (Seasoned)		Municipals (Bond Buyer)		(3 Month) Commercial Paper		90 Day CD's		Prime Rate	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1986	10.05	10.05	8.08	8.08	7.71	7.71	7.82	7.82	9.50	9.50
February	9.67	9.67	7.44	7.44	7.63	7.63	7.69	7.69	9.50	9.50
March	9.00	9.00	7.08	7.08	7.20	7.20	7.24	7.24	9.10	9.10
April	8.74	8.79	7.28	7.20	6.98	6.60	7.06	6.60	8.69	8.83
May	8.89	9.09	7.47	7.54	6.95	6.62	7.02	6.65	8.50	8.50
June	8.75	9.13*	7.31	7.83*	6.98	6.75*	7.05	6.78*	8.50	8.50
July	8.98	8.76	7.59	7.35	6.85	6.47	6.93	6.50	8.50	8.18*
August	9.07	8.53	7.66	7.11	6.80	6.35	6.89	6.42	8.50	8.00
September	9.05	8.56	7.63	7.19	6.96	6.48	7.11	6.53	8.50	8.00
October	9.26	8.43	7.82	7.04	7.33	6.25	7.42	6.32	8.67	8.00
November	9.35	8.51	7.89	7.19	7.38	6.46	7.50	6.53	9.00	8.00
December	9.41	8.55	7.92	7.27	7.45	6.55	7.58	6.62	9.00	8.00
January 1987	9.43	8.72	7.95	7.46	7.48	6.68	7.56	6.75	9.00	8.00
February	9.39	8.83	7.83	7.59	7.52	6.73	7.63	6.84	9.00	8.00
March	9.35	8.72	7.78	7.46	7.46	6.67	7.60	6.76	9.00	8.00
April	9.29	8.75	7.66	7.53	7.25	6.65	7.41	6.73	9.00	8.00
May	9.26	8.56	7.62	7.36	7.16	6.38	7.36	6.49	9.00	8.00
June	9.28	8.42	7.65	7.20	7.07	6.35	7.21	6.46	9.00	8.00

Fore. = May Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

Georgia State University

a unit of the university system of Georgia

8/12/86 11880-3
university plaza
atlanta, georgia 30303-3083

college of business administration
economic forecasting center
404 658 3282

MONTHLY PROJECTIONS July 1986

Dr. Donald Ratajczak, Director
For Release: July 30, 1986

SLOW GROWTH TO PERSIST THROUGH 1987

In recent weeks two diametrically opposed forecasts of future economic activity have been released. According to analysts at Merrill Lynch the weakness that already is apparent in the southwest and is also reflected in capital spending as a result of plunging oil prices will begin to spread. Consumer spending, which has been at a brisk 6% rate after adjustment for inflation will be forced to slow dramatically. Even housing will have no growth opportunities, as the southwest slump will not be offset by any strengthening of activity elsewhere. Although modest economic expansion of the 1.1% variety that appeared during the spring could be achieved this summer, according to Merrill Lynch, this will be caused by the absence of further inventory liquidation as producers fail to anticipate the developing sales slump. A recession could then begin during the fourth quarter.

The Administration's midyear update concedes that economic activity will not reach their 4% projections (growth was only 2.4% during the first half). However, increasing economic strength is expected to propel the economy to a 4½% rate of expansion in 1987. Although most economists believe this forecast is too high, most forecasts agree that falling energy prices, declining interest rates, and projected improving trade balances in response to a declining dollar should lead to more rapid economic growth in the months ahead. Unstated but also contained in the analysis is the belief that money growth has been sufficient to restimulate the U.S. economy.

Economic activity almost certainly will rebound from the second quarter's 1.1% growth unless final sales collapse, as envisioned by Merrill Lynch. Major areas of weakness in the second quarter were expenditures on structures, most of which reflected the collapse in oil and gas exploration, reductions in inventory accumulation, and a substantial decline in trade balances. While further weakness should be anticipated in oil exploration, rig counts already were below 700 at the end of the quarter. Indeed, a rebound in active rigs by 29 to 692 by mid-July may indicate that weakness in oil exploration is approaching a trough. Structures almost certainly will decline further during the summer months, but they are not expected to fall by the \$16 billion after inflation that occurred

during the spring. A \$20 billion decline in trade balances reflected a surge in imports of petroleum products. Such a substantial increase in imports should not develop in the third quarter, as renewed price declines in oil products are discouraging inventory holdings. Finally, although inventory investments could slow further during the third quarter, they are unlikely to slow by another \$25 billion. If they did, the economy would actually be experiencing significant inventory liquidation.

It should also be noted that economic activity in June was significantly reduced by a major labor dispute in the communications industry. Nearly \$3 billion of wage income was lost in June because of strike activity. Of course, strike activity could again reduce economic activity in August as a result of stoppages in the steel industry.

For the Merrill Lynch outlook to be correct, obvious improving sectors must be offset by previously strong areas that are weakening. Housing certainly ranks as one of those areas beginning to show strain. After averaging nearly 2 million starts during the first quarter, starts have fallen to 1.845 million in June. Permits also have slumped by 140,000 from their April peak. Some of this weakness reflects the slump in housing activity in the southwest. Some of it shows the beginning of apprehension in the rental markets as a result of anticipated tax reforms. Both those factors will be subtracting from housing for the remainder of this year and into 1987. However, some of the weakness in single family starts reflects a backlog of finance that developed during the spring when mortgage rates fell below 10%. The surge in refinancing overwhelmed financial institutions and pushed some new sales contracts out of the way. This backlog is diminishing and should cause a modest rebound in single family starts into the fall. Nevertheless, real construction spending probably has already peaked for this year and will decline by at least 10% next year.

Spending by governmental entities also should grow slowly. Attempts to substantially lower budgetary deficits in the United States should lead to more sluggish spending programs by the federal government. In addition, budgetary problems in the southwest will sharply restrain public spending there. However, lower oil prices are reducing some spending burdens in other parts of the country. Nevertheless, government support for the economy should be slowing during the next year.

Not only is budgetary spending expected to provide less support for economic growth in the next year, but tax reform may lead to a tax increase in 1987 if the staggered initiation of tax changes remains in the legislation. (The conference committee is trying desperately to make the base-widening and rate reduction coincide, but there might not be enough revenue to permit such a result). Staggered taxes would lead to more modest capital spending and weaker consumer spending than otherwise would prevail.

While previous strengths in government spending and housing activity almost certainly will diminish, they will not be sufficient to offset the developing strengths in the trade account, in inventory changes, and in diminished reductions in oil exploration.

Therefore, the Merrill Lynch forecast can only be correct if consumer spending significantly slows over the next six months. Some slowing appears to be inevitable, as the savings rate is at a relatively low 4.5% and consumer debt

continues to grow nearly twice as rapidly as consumer income. Furthermore, personal income has been aided by significant farm subsidy payments. These payments almost certainly will diminish during the second half of 1986. Although oil prices appear to be falling again during the summer months, they eventually will reach a low point from which price increases can be anticipated. At that point, real purchasing power will be sharply restrained. At the same time that the ability to purchase should grow more slowly, the desire to purchase may also taper off. Automobile sales already are at 11 million on the basis of significant financing incentives. Those incentives probably will not get richer while rising prices for imports and, to a lesser extent, domestic units should gradually reduce auto sales. Household durables also should begin slowing about six months after housing activity begins to slow. Thus, spending on consumer durables should show little growth over the next year despite a 9% surge in orders for household durables in June. In short, weakness in consumer spending should begin to materialize. In fact, Christmas activity should be relatively sluggish. While the foundations for the Merrill Lynch forecast can be constructed by diminishing the rebound in the areas gaining strength and increasing weakness in the areas that are slowing, our projections cannot generate the degree of pessimism expressed in that forecast.

Needless to say, the Administration's forecast simply ignores any of the potential areas of weakness. They rely upon a significant improvement in the trade accounts despite little evidence that the dollar's falling value has materially affected domestic prices. Generally, trade balances take up to a year to respond to changes in international competitiveness. However, international competitiveness has not yet significantly responded to changes in the dollar's value. This delayed response in changing the competitiveness of American producers almost certainly delays the trade response as well. While the trade accounts almost certainly will be improving over the next year, administration projections are excessively optimistic.

If neither a significant rebound nor a substantial collapse can be generated by prevailing conditions, it appears that enough sectors will be strengthening to offset those sectors that will be weakening. Therefore, a continuation of 2.5% growth appears likely well into 1987.

Quarterly Profile of GNP

	1986-1	1986-2	1986-3	1986-4	1987-1	1987-2	1986 Annual
Real:	3.8	1.1	3.3	1.4	1.7	2.7	2.7
Price:	2.5	2.1	2.7	3.9	4.2	4.0	2.8
Nominal:	6.2	3.2	6.2	5.4	5.9	6.9	5.5

Monthly Statistical Highlights for July 1986

Payroll employment +304,000; index of hours worked +0.4%; household employment +122,000; civilian unemployment rate 7.1%; personal income +0.4%; savings rate 4.3%; personal consumption +0.5%; retail sales +0.2%; auto sales 10.9 million; housing starts -0.3%; housing permits -1.2%; construction expenditures -0.4%; business inventories +0.0%; orders for durable goods -0.5%; orders for nondefense capital goods +1.8%; industrial production +0.5%; CPI +0.1%; PPI -0.4%; consumption deflator +0.3%; leading indicators +0.2%; real GNP +5.3%; M1 +16.2%; M2 +8.4%.

Monthly Statistical Highlights For August 1986

Payroll employment +161,000; index of hours worked +0.2%; household employment +181,000; civilian unemployment rate 7.0%; personal income +0.4%; savings rate 4.3%; personal consumption +0.5%; retail sales +0.5%; auto sales 11.0 million; housing starts +0.8%; housing permits -1.2%; construction expenditures -0.3%; business inventories +0.1%; orders for durable goods +1.6%; orders for nondefense capital goods +1.8%; industrial production +0.2%; CPI +0.1%; PPI -0.2%; consumption deflator +0.1%; leading indicators +0.2%; real GNP +2.3%; M1 +7.9%; M2 +7.3%.

COMMENTARY

Employment - Although a return to work by AT&T workers will generate a surprisingly large increase in payroll employment, gains will only be 133,000 after strike factors are excluded. This compares with an 89,000 gain before strike conditions in June. Strike activity will again distort employment and economic activity in August as a result of looming steel strike problems.

According to insured unemployment rates, unemployment could increase slightly in July although our current projections suggest little change.

Personal Income & Outlays - Reduced farm subsidies led to little change in personal income during June. Further erosion in farm subsidies is expected in July, but this should be offset by significant gains in wage and salary employment. Property income is growing at a relatively slow \$1 billion per month, but no speed up in that sector is expected until interest rates rebound.

Data revisions led to significantly greater gains in disposable income than originally projected. While some of this increased spending potential was utilized in purchasing higher levels of service expenditures, a significant portion of it was saved. As a result, savings rates have not been as low as originally

projected. In particular, a significant upward revision occurred in property income. However, the falloff in property income growth should be reflected in reduced savings during the next several months.

Although services received most of the benefit from GNP revisions, retail sales were also revised sharply upward for May and April. These upward revisions were both in nondurables and the nonauto component of durables. To some extent, the upward revisions in durables were reflected in the expenditures data. However, increases in nondurable retail sales activity were not reflected in the non-durable expenditures.

Construction - Construction expenditures were revised significantly upward as a result of upward revisions in residential spending. Public construction also was revised upward slightly. However, nonresidential construction appears to be dropping sharply as a result of weakness in both industrial and commercial activities. Industrial activity is expected to strengthen slightly but further weakness is projected for commercial construction.

Housing activity has been restrained by the financing backlog. However, hopes that no significant changes in tax codes would materialize have vanished. This already is causing housing permits to slump and will soon cause a significant decline in rental property activity. In June, multiple family starts were at 622,000 units. A year from now, as a result of the impact of tax reform, those starts are expected to be at 533,000 units.

Although the construction deflator was rebenchmarked to a 1982 average of 100, the surge in construction costs did not moderate. Because of rapid growth in construction prices, the GNP deflator is expected to increase 2.8% in 1986. This will be substantially greater than the 1.8% advance expected for the CPI.

Business Activity - Both defense shipments and orders rebounded sharply in June. Orders now are nearly \$2 billion above shipments. A correction in defense orders almost certainly will materialize next month. On the other hand, shipments of nondefense capital goods are nearly \$0.5 billion above orders despite a rebound in orders during June. Further growth in both orders and shipments are anticipated until the beginning of 1987. However, gains in capital spending are expected to slow significantly in the second half of 1986 before they decline modestly in 1987.

Increases in communications equipment activity at the end of the AT&T strike should cause a significant rebound in the business equipment component of industrial production. Slight increases in activities for business materials and utilities should more than offset continuing weakness in the mining areas. As a result, industrial production is expected to expand by 0.5% in July.

Prices - GNP revisions tended to raise the consumption deflator slightly as higher price increases for services were only partially offset by lower prices for consumer durables. Service prices should increase sharply in the next few months as the result of an unexpected increase in prices of utilities in June. Nevertheless, further significant price increases for utilities are not warranted by economic pressures and should not materialize in the months ahead. Because of declining oil prices, the Consumer Price Index is expected to show only very modest increases in July and August. The Producers' Price Index for finished goods should decline. However, increasing meat prices will blunt the magnitude of this price weakness.

Miscellaneous - According to estimates of monthly GNP movements following the quarterly GNP revisions, it appears that all the strength during the second quarter occurred in April. A similar pattern is expected to develop in the third quarter, when a post-strike rebound in GNP during July will show little further strengths in subsequent months. Once oil prices stabilize in the fourth quarter, GNP growth is expected to slow significantly, at least until the spring of 1987.

Financial Markets

The yield curve once again has become steeper as long term interest rates have moved upward even as short term interest rates have continued to fall. It is noteworthy that commercial paper rates are significantly below federal funds rates in July. Thus, inventory liquidations probably are continuing. Of course, an inventory rebound later in the year along with renewed accumulation of oil products should once again strengthen short term rates. It is possible that the increase in long term rates reflects the probability of higher short term rates late this year and early next year. More likely, however, it is the concern over government refinancing. There is a growing concern that foreign investors will be increasingly reluctant to invest in long term government instruments in the United States. While foreign investors do not see a resurgence of inflationary pressures, they see a reduced willingness by the Federal Reserve to support the dollar's value. As a result, their expected rates of return from dollar denominated investments has sharply diminished. This shift in foreign investors' sentiment will be especially noteworthy in government securities, where the spread should narrow relative to corporate instruments.

Interest rates should not be demonstrating significant upward pressures at the present time. The government's deficit is increasing, but only marginally. When the impact of state and local governments are included, borrowings by all governments are not increasing at the present time. Corporate borrowings remain relatively sluggish, although inventory rebuilding sometime in the third quarter could increase those borrowings modestly. Of course, corporate earnings remain relatively weak although productivity gains are reappearing. Thus, the loss of corporate profitability is not expected to be dramatic. Only the household sector is showing a diminished net supply to the credit markets. As the financing backlog diminishes, increased mortgage borrowings for new homes should reappear. In addition, households are expected to marginally reduce their rates of savings during the summer months. On balance, however, conditions are favorable for further reduction in interest rates.

It is apparent that rapid money growth is not affecting transactions activity. Evidence is mounting to demonstrate that changes in interest rates substantially increased the demand for checkable deposits. These gains are also forcing the Federal Reserve to accommodate by increasing available reserves. Indeed, the increased demand for checkable deposits as savings instruments suggests that such an accommodation by the Federal Reserve is warranted. If the Federal Reserve had followed a money rule instead of looking at economic performance, it would have engineered a severe slump by the present time. Stability of the checkable deposits equation is open to serious doubts following the recent performance of that instrument.

Equity Markets - The equity markets continue to be buffeted by transitional problems associated with the tax reform legislation. The tax rate on capital

gains may appreciate significantly, leading to significant equity sales. In addition to tax-selling problems, the stock market must contend with rising long term interest rates. This increase in long term rates appears to be the result of changing investors' sentiments by foreign investors. As a result, equity values probably will continue to correct until the stock market reaches a 1650 value on the Dow.

Despite our short term concerns about equity values, our projections indicate that interest rates will not be thwarting increased equity values in 1987. In addition, continued moderation in wage demands and reasonably strong productivity gains suggest that profits will grow. As a result, a 9% increase in equity values currently is projected in 1987, which should take the Dow Jones to the vicinity of 2300. Buying opportunities may surface on both the equity and bond market as early as the end of the summer months.

EMPLOYMENT

	Payroll Employment		Index of Hours Worked		Household Civilian Employment		Civilian Unemployment Rate		Hourly Earnings Index	
	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.
January 1986	99496	99290	119.1	117.8	108955	108955	6.7	6.7	167.4	167.3
February	99549	99429	118.5	117.5	108561	108561	7.2	7.3	168.4	168.2
March	99841	99484	118.9	117.4	108788	108788	7.2	7.2	168.8	168.5
April	100029	99783	119.2	117.8	109024	108892	7.1	7.1	169.2	168.4
May	100296	99908	119.5	117.7	109265	109110	7.0	7.3	169.3	168.6
June	100563	99819	119.8	117.5	109512	109673	7.0	7.1	169.5	169.4
July	100778	100123*	120.1	118.0*	109773	109795*	6.9	7.1*	170.2	169.6*
August	100972	100284	120.5	118.2	109975	109976	6.8	7.0	170.8	170.0
September	101065	100443	121.0	118.4	110178	110164	6.7	7.0	171.4	170.5
October	101397	100621	121.2	118.6	110418	110361	6.7	6.9	171.9	170.9
November	101649	100802	121.4	118.8	110753	110575	6.6	6.9	172.5	171.3
December	102015	100994	121.6	119.0	111130	110795	6.5	6.9	173.1	171.8
January 1987	102098	101166	121.8	119.2	111275	110959	6.5	6.8	173.5	172.3
February	102197	101322	121.9	119.4	111358	111136	6.5	6.8	173.9	172.7
March	102295	101468	122.0	119.5	111439	111312	6.4	6.8	174.4	173.2
April	102468	101637	122.2	119.7	111694	111502	6.4	6.7	174.9	173.8
May	102705	101759	122.5	119.8	111918	111642	6.3	6.7	175.4	174.3
June	102921	101913	122.8	120.0	112142	111783	6.3	6.8	176.0	174.9

PERSONAL INCOME

	Personal Income		Wage & Salary		Personal Savings		Disposable Income		Personal Outlays	
	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.
January 1986	3.387	3.418	2.027	2.038	124.7	145.0	2.882	2.921	2.758	2.776
February	3.401	3.435	2.034	2.045	125.7	142.0	2.896	2.937	2.771	2.795
March	3.407	3.445	2.044	2.052	122.9	149.8	2.904	2.948	2.781	2.798
April	3.432	3.485	2.052	2.053	127.8	182.4	2.926	2.987	2.788	2.805
May	3.429	3.476	2.062	2.056	127.3	151.6	2.921	2.976	2.794	2.824
June	3.435	3.479	2.073	2.063	124.0	133.2	2.928	2.975	2.805	2.842
July	3.459	3.494*	2.081	2.075*	121.9	128.6*	2.944	2.986*	2.822	2.857*
August	3.482	3.509	2.092	2.085	121.7	124.6	2.962	2.997	2.841	2.872
September	3.506	3.527	2.103	2.096	121.7	126.3	2.981	3.012	2.860	2.885
October	3.526	3.540	2.113	2.106	118.7	127.3	2.996	3.025	2.878	2.898
November	3.547	3.556	2.125	2.115	120.7	127.2	3.012	3.038	2.892	2.910
December	3.569	3.575	2.137	2.127	123.0	125.8	3.029	3.053	2.906	2.927
January 1987	3.575	3.590	2.148	2.138	120.7	124.3	3.042	3.069	2.922	2.945
February	3.598	3.607	2.158	2.149	120.6	126.3	3.061	3.085	2.940	2.959
March	3.633	3.622	2.168	2.158	132.4	123.5	3.090	3.097	2.958	2.974
April	3.640	3.643	2.179	2.171	116.6	121.7	3.094	3.115	2.977	2.993
May	3.649	3.659	2.187	2.180	104.8	119.5	3.098	3.127	2.993	3.008
June	3.659	3.680	2.196	2.193	96.7	122.4	3.104	3.145	3.009	3.023

Fore. = May Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

CONSUMPTION

	Personal Consumption		Durables		Nondurables		Services		Consumption Real	
	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.
January 1986	2659.6	2684.7	368.8	364.9	933.9	925.4	1356.9	1394.6	2337.3	2351.6
February	2671.5	2703.1	364.0	365.5	935.0	927.6	1372.5	1410.0	2357.5	2377.5
March	2680.8	2705.9	354.4	352.0	948.6	936.1	1377.8	1417.6	2374.4	2389.0
April	2687.0	2712.0	365.0	369.7	936.4	920.4	1385.6	1421.9	2382.1	2396.1
May	2692.3	2731.0	366.2	378.9	930.2	925.6	1395.9	1426.5	2378.4	2407.6
June	2706.1	2747.3	364.7	375.4	935.1	931.9	1406.3	1439.9	2380.0	2397.7*
July	2723.5	2762.4*	369.8	374.5*	939.2	936.6*	1414.5	1451.3*	2389.0	2423.4
August	2736.4	2776.6	371.6	377.6	943.8	938.4	1421.0	1460.6	2396.1	2433.2
September	2750.0	2788.7	374.1	379.9	948.3	940.3	1427.6	1468.5	2403.8	2434.9
October	2769.3	2800.5	376.8	381.0	955.7	943.6	1436.8	1475.9	2412.3	2437.3
November	2786.4	2812.3	379.2	380.7	960.3	947.0	1446.9	1484.6	2414.6	2441.0
December	2798.5	2828.4	380.6	382.0	960.7	950.1	1457.2	1496.3	2412.5	2445.3
January 1987	2813.7	2845.1	381.9	384.2	966.5	955.2	1465.3	1505.7	2419.3	2449.6
February	2830.0	2858.4	381.6	385.2	973.8	959.4	1474.6	1513.8	2425.0	2452.5
March	2846.9	2872.5	381.0	384.7	981.4	965.2	1484.5	1522.6	2431.2	2458.8
April	2867.7	2891.0	387.4	388.0	986.5	971.3	1493.8	1531.7	2440.6	2467.5
May	2880.4	2904.9	386.7	387.2	990.7	976.3	1503.0	1541.4	2441.0	2469.1
June	2890.7	2919.2	386.8	388.4	991.6	980.3	1512.3	1550.5	2439.4	2471.1

RETAIL SALES

	Retail Sales		Non-Auto Durables		Auto (Million Units)		Nondurable Sales		Auto Sales	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1986	117.35	117.35	17.86	17.86	11.5	11.5	73.16	73.16	26.33	26.33
February	117.45	117.20	17.97	17.91	10.6	10.9	73.25	73.25	26.04	26.04
March	116.17	116.68	18.07	18.25	9.7	9.7	73.19	73.41	24.83	25.03
April	116.43	117.72	18.05	18.52	10.6	11.0	72.25	72.84	26.13	26.36
May	116.10	118.52	18.12	18.38	10.5	11.3	71.77	73.19	26.21	26.95
June	116.40	118.70	18.20	18.25	10.4	11.0	72.15	73.30	26.05	27.16
July	116.94	118.97*	18.36	18.36*	10.4	10.9*	72.47	73.67*	26.11	26.94*
August	116.97	119.49	18.53	18.52	10.2	11.0	72.82	73.81	25.62	27.16
September	117.62	119.92	18.62	18.60	10.3	11.1	73.17	73.96	25.83	27.36
October	118.51	120.31	18.60	18.76	10.5	11.0	73.74	74.22	26.17	27.33
November	119.34	120.54	18.72	18.88	10.8	10.8	74.09	74.49	26.53	27.17
December	119.54	120.94	18.79	18.93	10.8	10.8	74.12	74.73	26.63	27.28
January 1987	120.14	121.60	19.02	18.94	10.7	10.9	74.57	75.13	26.55	27.53
February	120.67	121.06	19.07	19.01	10.6	10.9	75.13	75.46	26.47	27.59
March	121.19	122.46	19.15	19.06	10.5	10.8	75.72	75.92	26.32	27.48
April	122.34	123.34	19.31	19.13	10.9	10.9	76.11	76.40	26.92	27.81
May	122.59	123.63	19.42	19.27	10.7	10.7	76.44	76.79	26.73	27.57
June	122.67	124.09	19.58	19.30	10.5	10.7	76.51	77.11	26.58	27.68

Fore. = May Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

CONSTRUCTION

	Housing Starts		Single Family Starts		Housing Permits		Construction Expenditures (Current)		Construction Expenditures (Real)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1986	2.034	2.034	1.335	1.335	1.899	1.861	356.1	373.4	206.9	337.7
February	1.997	2.001	1.204	1.202	1.803	1.808	360.5	373.9	209.2	338.3
March	1.949	1.960	1.212	1.221	1.846	1.834	367.2	368.0	212.5	331.8
April	1.966	2.019	1.256	1.242	1.833	1.885	368.4	371.6	212.6	331.8
May	1.940	1.861	1.237	1.247	1.792	1.788	370.6	374.7	213.1	331.6
June	1.950	1.845	1.254	1.223	1.796	1.745	372.8	372.9*	213.8	328.3*
July	1.948	1.840*	1.270	1.215*	1.813	1.724*	374.0	371.4	213.7	325.2
August	1.923	1.854	1.281	1.237	1.756	1.703	376.0	370.3	214.1	322.8
September	1.874	1.831	1.268	1.253	1.721	1.669	376.9	369.9	214.0	320.8
October	1.882	1.796	1.260	1.250	1.695	1.643	378.5	369.4	214.3	319.0
November	1.875	1.783	1.258	1.241	1.704	1.655	379.0	368.3	213.9	317.0
December	1.847	1.715	1.235	1.196	1.688	1.584	379.2	367.2	213.3	314.9
January 1987	1.761	1.697	1.172	1.172	1.615	1.562	378.9	364.3	212.5	311.6
February	1.719	1.650	1.146	1.154	1.567	1.526	378.5	362.4	211.7	309.0
March	1.698	1.639	1.141	1.162	1.528	1.483	377.6	360.5	210.5	306.0
April	1.694	1.652	1.129	1.153	1.533	1.521	375.6	359.2	208.8	303.9
May	1.698	1.656	1.122	1.129	1.539	1.524	374.0	358.5	207.2	302.5
June	1.691	1.676	1.127	1.143	1.552	1.543	371.8	359.2	205.4	302.4

	Non-Residential		Public Construction		Residential Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1986	135.4	142.0	68.1	68.0	152.6	163.4
February	137.8	141.0	66.9	68.3	155.8	164.7
March	138.6	133.3	67.3	69.2	161.3	165.6
April	139.1	133.4	67.6	70.5	161.7	167.8
May	139.6	130.5	68.0	74.4	163.0	169.8
June	140.2	130.7*	68.2	73.7*	164.4	168.5*
July	140.0	129.5	68.5	73.9	165.5	168.0
August	140.3	129.3	68.9	74.3	166.8	166.7
September	139.7	128.6	69.3	74.0	167.9	167.3
October	140.5	128.5	69.8	73.9	168.2	167.0
November	140.9	127.6	70.1	74.5	168.0	166.2
December	141.0	127.0	70.5	74.9	167.7	165.3
January 1987	141.2	126.3	70.7	75.2	167.0	162.8
February	141.3	126.6	70.9	75.5	166.3	160.3
March	141.1	127.2	70.9	75.3	165.6	158.0
April	141.2	126.6	71.2	75.8	163.2	156.8
May	141.4	126.1	71.4	76.1	161.2	156.3
June	141.1	125.8	71.4	76.5	159.3	156.9

Fore. = May Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

BUSINESS ACTIVITY

	Manufacturers' Inventories		Durable Goods Orders		Non-Defense Capital Goods Orders		Non-Defense Capital Shipments	
	Fore. C.E.		Fore. C.E.		Fore. C.E.		Fore. C.E.	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1986	280.4	280.4	108.46	108.19	24.55	24.29	25.60	25.35
February	279.5	279.2	107.82	107.55	28.91	28.64	26.86	26.56
March	278.7	279.6	105.07	104.68	27.02	26.54	27.82	27.30
April	278.2	279.4	105.09	103.75	27.20	26.18	27.40	27.36
May	279.0	278.4	106.01	102.62	27.63	26.15	27.58	26.58
June	280.3	278.2*	105.84	104.77	27.85	26.74	27.76	27.22
July	281.1	278.5	107.13	104.25*	28.46	26.95*	27.85	27.25*
August	282.2	278.8	106.67	105.93	28.40	27.43	27.97	27.30
September	283.2	279.3	108.23	106.67	28.86	27.56	28.09	27.39
October	284.4	280.0	108.84	106.46	29.16	27.45	28.35	27.40
November	286.3	280.7	109.28	107.23	29.33	27.71	28.63	27.46
December	287.4	281.9	108.89	106.85	29.30	27.52	28.91	27.51
January 1987	288.8	283.0	108.37	105.47	29.21	27.16	29.05	27.38
February	290.3	284.3	109.52	106.35	29.34	27.43	29.11	27.44
March	292.5	285.5	109.76	106.67	29.22	27.21	29.17	27.25
April	294.9	286.9	108.83	106.05	29.12	27.05	29.35	27.33*
May	296.2	288.2	108.72	105.78	29.18	26.94	29.48	27.23
June	298.0	289.5	108.85	105.64	29.30	26.86	29.61	27.16

	Business Inventories		Defense Shipments		Industrial Production		Capacity Utilization	
	Fore. C.E.		Fore. C.E.		Fore. C.E.		Fore. C.E.	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1986	585.0	585.0	7.03	7.03	126.6	126.7	80.7	80.8
February	585.1	585.2	7.58	7.58	125.7	125.6	80.0	79.9
March	585.8	587.7	7.27	7.08	125.1	124.4	79.4	79.0
April	587.0	588.6	7.40	7.33	125.5	125.2	79.5	79.4
May	588.1	586.6	7.49	7.49	125.8	124.7	79.5	78.9
June	589.9	585.4*	7.59	7.83	126.4	124.1	79.7	78.3
July	591.2	585.6	7.68	7.92*	127.2	124.7*	80.0	78.5*
August	593.5	586.3	7.85	7.98	127.8	125.0	80.2	78.6
September	595.7	587.7	8.05	8.07	128.4	125.2	80.4	78.6
October	598.2	588.9	8.01	8.00	128.6	125.3	80.4	78.4
November	600.3	590.9	8.07	8.13	128.8	125.5	80.4	78.4
December	602.4	593.3	8.18	8.20	129.0	125.6	80.3	78.2
January 1987	605.8	596.1	8.25	8.29	128.9	125.8	80.1	78.2
February	609.9	597.8	8.33	8.35	129.1	126.1	80.1	78.3
March	613.9	599.5	8.40	8.43	129.2	126.3	80.0	78.3
April	617.1	602.4	8.38	8.50	128.8	126.4	79.7	78.2
May	620.8	605.8	8.45	8.49	128.5	126.5	79.4	78.1
June	623.3	609.2	8.52	8.57	128.2	126.5	79.1	77.8

Fore. = May Forecast

C.E. = Current Expectations

* = This item and those beyond it are expectations.

PRICES

	CPI-U		PPI		PPI-Industrial		Estimated GNP	
	(seasonally adjusted)		Finished Goods (seasonally adjusted)		Commodities (unadjusted)		Deflator	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1986	329.0	329.0	296.3	296.1	324.0	323.8	113.9	113.6
February	327.7	327.7	291.7	291.7	319.4	318.9	113.8	113.5
March	326.4	326.3	288.6	288.6	314.0	314.0	113.4	113.4
April	325.5	325.4	287.1	286.8	309.6	311.3	113.6	113.5
May	325.9	326.0	287.8	288.6	310.9	311.7	113.9	113.8
June	326.6	327.6	288.5	288.5	312.3	311.6	114.2	114.9
July	327.7	327.9*	290.3	287.4*	313.4	309.2*	114.4	114.6
August	328.8	328.2	291.0	287.0	314.7	309.9	114.7	114.8
September	330.0	329.4	291.7	288.1	331.6	308.3	115.0	115.2
October	331.0	330.6	292.3	289.5	315.8	310.6	115.4	115.6
November	331.9	331.5	293.5	290.1	316.1	311.4	115.8	115.9
December	332.8	332.8	294.5	291.3	316.5	312.2	116.2	116.4
January 1987	334.3	334.1	295.2	292.4	317.0	313.0	116.7	116.8
February	335.9	335.4	295.9	293.5	317.8	313.8	117.1	117.2
March	337.5	336.1	296.6	293.6	318.5	313.4	117.5	117.5
April	338.6	337.1	297.3	294.3	319.4	314.0	117.9	117.9
May	339.7	338.4	298.1	295.3	320.3	314.8	118.3	118.3
June	340.6	339.9	298.9	296.6	321.2	316.2	118.7	118.8

	Consumption		Consumer		Consumer		Consumer		Implicit	
	Deflator		Durables		Nondurables		Services		Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1986	113.8	114.1	104.9	104.7	109.8	109.7	119.5	120.3	172.1	110.6
February	113.3	113.7	105.0	104.7	108.1	107.9	119.8	120.6	172.3	110.6
March	112.9	113.3	105.0	104.0	106.8	106.5	120.3	121.0	172.8	110.9
April	112.8	113.2	105.2	104.4	106.1	105.6	120.6	121.5	173.3	112.0
May	113.2	113.4	105.3	104.9	106.0	105.8	121.0	121.7	173.9	113.0
June	113.7	113.7*	105.5	105.1*	106.2	105.9*	121.4	122.1*	174.4	113.6*
July	114.0	114.0	105.6	105.4	106.4	105.8	122.0	122.7	175.0	114.2
August	114.2	114.1	105.7	105.7	106.5	105.5	122.7	123.1	175.6	114.7
September	114.4	114.5	105.8	105.9	106.7	106.0	123.4	123.5	176.1	115.3
October	114.8	114.9	106.1	106.3	107.1	106.3	123.8	123.9	176.6	115.8
November	115.4	115.2	106.4	106.6	107.6	106.7	124.1	124.1	177.2	116.2
December	116.0	115.7	106.7	106.9	108.1	107.1	124.5	124.6	177.8	116.6
January 1987	116.3	116.1	107.0	107.2	108.4	107.5	125.0	125.2	178.3	116.9
February	116.7	116.6	107.3	107.5	108.7	107.7	125.6	125.8	178.8	117.3
March	117.1	116.8	107.6	107.7	109.0	108.0	126.1	126.3	179.4	117.8
April	117.5	117.2	107.9	108.0	108.9	108.0	126.7	126.7	179.9	118.2
May	118.0	117.6	108.2	108.3	109.0	108.5	127.3	127.2	180.5	118.5
June	118.5	118.1	108.5	108.6	109.2	108.9	128.0	127.8	181.0	118.8

Fore. = May Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

MISCELLANEOUS

	Merchandise Trade Balance		Leading Indicators		Estimated GNP		Estimated GNP (1982 \$)		IVA (annual rate)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1986	-14.93	-15.00	174.1	173.4	4116	4153	3614	3656	0.8	1.6
February	-14.21	-11.16	175.4	175.2	4115	4147	3616	3654	13.3	14.8
March	-14.03	-13.06	176.4	176.2	4118	4147	3631	3657	27.9	32.2
April	-12.73	-14.02	177.3	178.5	4127	4167	3633	3671	30.3	19.6
May	-12.52	-14.27p	178.2	178.8	4156	4173	3649	3667	14.2	2.8
June	-12.32	-12.46*	178.4	179.2	4203	4207	3680	3661	6.2	-7.7
July	-11.96	-12.29	178.2	179.5*	4221	4230	3690	3691	1.6	-3.2
August	-12.06	-12.37	177.5	179.9	4241	4245	3697	3698	-3.5	2.7
September	-12.20	-12.04	178.0	179.7	4262	4261	3706	3699	-8.3	7.3
October	-12.15	-11.89	178.3	179.5	4288	4275	3716	3698	-8.0	4.2
November	-12.03	-11.76	178.7	179.9	4315	4302	3726	3712	-7.2	1.6
December	-11.90	-11.55	178.3	179.6	4342	4328	3737	3718	-6.5	-2.7
January 1987	-11.95	-11.72	177.2	179.1	4363	4347	3739	3722	-8.6	-3.9
February	-11.91	-11.75	177.3	179.0	4385	4360	3745	3720	-10.9	-6.6
March	-11.86	-11.61	176.8	178.8	4406	4386	3750	3733	-12.5	-8.1
April	-11.80	-11.25	176.1	178.9	4424	4418	3752	3747	-12.1	-4.3
May	-11.72	-11.43	175.5	178.5	4440	4437	3753	3751	-11.6	-4.9
June	-11.64	-11.16	175.3	178.0	4455	4459	3753	3753	-11.4	-7.2

Fore. = May Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

FINANCIAL MARKETS

	Monetary Base		M1		M2		Federal Funds		T-Bills (6 Mos.)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1986	235.8	235.7	627.2	627.2	2568.5	2569.1	8.14	8.14	7.16	7.16
February	237.8	237.7	631.0	631.1	2576.3	2576.8	7.86	7.86	7.11	7.11
March	239.0	238.7	638.4	638.4	2590.4	2591.3	7.48	7.48	6.57	6.57
April	240.2	239.9	642.3	646.1	2607.4	2621.6	7.07	6.99	6.33	6.08
May	241.2	242.3	645.3	658.6	2622.3	2647.0	7.04	6.85	6.22	6.19
June	242.3	244.2	648.4	666.3	2637.1	2667.3	6.99	6.92	6.12	6.27
July	244.2	245.6*	653.3	674.7*	2653.2	2685.2*	6.89	6.58*	6.23	5.85*
August	245.7	246.9	658.0	679.0	2675.1	2700.2	6.78	6.32	6.35	5.77
September	247.2	248.0	662.7	682.0	2697.0	2713.7	6.95	6.38	6.46	5.86
October	248.8	249.3	664.5	685.6	2710.2	2727.9	7.26	6.28	6.59	5.77
November	250.1	250.5	666.0	689.1	2720.1	2741.9	7.32	6.39	6.68	5.88
December	251.4	251.8	667.6	692.5	2730.0	2755.6	7.38	6.51	6.77	6.03
January 1987	252.6	253.2	672.0	696.3	2749.8	2770.3	7.42	6.55	6.85	6.13
February	253.7	255.0	676.9	701.3	2769.2	2786.9	7.46	6.34	6.83	5.89
March	254.9	256.8	681.8	705.7	2782.6	2804.3	7.50	6.28	6.78	5.76
April	256.3	258.2	682.5	708.8	2796.6	2818.3	7.32	6.47	6.65	5.93
May	257.4	259.8	683.4	713.2	2809.2	2835.6	7.20	6.69	6.59	6.12
June	258.5	261.1	684.2	716.5	2822.1	2852.6	7.11	6.77	6.53	6.21

	Aaa (Seasoned)		(3 Month) Municipals (Bond Buyer)		Commercial Paper		90 Day CD's		Prime Rate	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1986	10.05	10.05	8.08	8.08	7.71	7.71	7.82	7.82	9.50	9.50
February	9.67	9.67	7.44	7.44	7.63	7.63	7.69	7.69	9.50	9.50
March	9.00	9.00	7.08	7.08	7.20	7.20	7.24	7.24	9.10	9.10
April	8.74	8.79	7.28	7.20	6.98	6.60	7.06	6.60	8.69	8.83
May	8.89	9.09	7.47	7.54	6.95	6.62	7.02	6.65	8.50	8.50
June	8.75	9.13	7.31	7.87	6.98	6.71	7.05	6.73	8.50	8.50
July	8.98	8.93*	7.59	7.52*	6.85	6.32*	6.93	6.38*	8.50	8.14*
August	9.07	8.77	7.66	7.39	6.80	6.25	6.89	6.35	8.50	8.00
September	9.05	8.86	7.63	7.49	6.96	6.41	7.11	6.50	8.50	8.00
October	9.26	8.73	7.82	7.35	7.33	6.24	7.42	6.35	8.67	8.00
November	9.35	8.92	7.89	7.56	7.38	6.37	7.50	6.46	9.00	8.00
December	9.41	9.13	7.92	7.76	7.45	6.55	7.58	6.68	9.00	8.00
January 1987	9.43	9.22	7.95	7.86	7.48	6.63	7.56	6.75	9.00	8.00
February	9.39	9.06	7.83	7.65	7.52	6.32	7.63	6.45	9.00	8.00
March	9.35	8.87	7.78	7.45	7.46	6.23	7.60	6.34	9.00	8.00
April	9.29	8.98	7.66	7.59	7.25	6.51	7.41	6.60	9.00	8.00
May	9.26	9.14	7.62	7.77	7.16	6.73	7.36	6.89	9.00	8.17
June	9.28	9.06	7.65	7.66	7.07	6.75	7.21	6.87	9.00	8.50

Fore. = May Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

Georgia State University

a unit of the university system of georgia

university plaza
atlanta, georgia 30303-3083

college of business administration
economic forecasting center
404 658-3282

MONTHLY PROJECTIONS August 1986

Dr. Donald Ratajczak, Director
For Release: September 4, 1986

ECONOMIC SPUTTER BUT NOT STAGNATION AHEAD

A record \$18.04 billion trade deficit in the preliminary estimates for July virtually demolished any prospects of an early return to healthy economic expansion. Unless a miraculous improvement in trade develops in the next few months, and none is foreseen, trade balances once again will be subtracting from economic activity during the summer months. When this is coupled with a housing market that is beginning to stall, a consumer that clearly is exhausting purchasing power, the remnants of a slump in oil and gas exploration, and lackadaisical investment spending, economic growth during the summer months will be barely strong enough to prevent the economy from experiencing back-to-back growth rates of less than 1%, the economic condition that would prevent Gramm-Rudman budget restraints for the following four quarters. While auto sales definitely will respond dramatically to the latest financing incentives these sales will come from inventories and will only influence production schedules during the fourth quarter. To the extent that auto sales further exhaust consumer spending power, merchandisers will be especially cautious in ordering for the Christmas season. Thus, the economy will continue to sputter until trade deficits begin to recede and the construction sector has fully adjusted to changing tax codes.

Recently, some analysts have begun to dust off concerns about stagflation. This is a condition where rising prices rob consumer purchasing power, leading to little employment growth even as inflation gradually intensifies. These concerns about stagflation have been generated by three important developments.

First, OPEC appears to be achieving its goal of producing 16.8 million barrels in September and October. As a result, oil prices have remained firm at slightly over \$16 per barrel. This is a dramatic reversal from plunging prices a month earlier. Not only has the OPEC initiative eliminated inflation restraining effects from falling oil prices, but has added to inflationary pressures in August and September. The PPI in August is expected to rise 0.4%. The CPI probably will also show a 0.4% gain. These contrast sharply with a July PPI decline of 0.4% and an unchanged CPI for July. In September, increasing oil prices may coincide with gradually firming agricultural prices to lead to inflation estimates at a 6% annual rate. Unless oil prices firm further, no more

significant inflationary pressures are expected in subsequent months, but the psychological damage associated with this brief flurry of intensifying inflation may not be lost upon consumer spending patterns.

Second, the price of gold has surged above \$400 per ounce. There appears to be two satisfactory explanations for this rise in gold price that has little to do with inflation. Turmoil in South Africa increases prospects that supplies may temporarily be restrained. This is especially true of platinum, whose price has soared by more than 36% in the past month. Also, the Japanese are producing a commemorative gold coin to celebrate Emperor Hirohito. Apparently, the demand for this gold coin could exhaust more than \$5 billion of gold. Despite these obvious influences upon gold's price, speculators have jumped upon the rising gold price trend in an effort to excite an otherwise languishing commodity market. They have charged that rising prices for precious metals indicate increasing inflationary concern and have been fortunate to sell this argument in an environment where prices are rising. As a result, a speculative surge in precious metals may now cause prices to surge to \$500, at least until the Hirohito coin has been completely distributed. This speculative activity may create upward price pressures for other commodities. In particular, many grains prices currently are below production costs and could easily rebound from these unsustainable low levels. Thus, a slight inflationary boomlet can easily feed upon itself.

Third, rapid money growth may now exceed the transactions and liquidity needs of the U.S. economy. During the past two discount rate reductions, short-term rates have fallen in step with declining federal funds rates but long-term rates have not declined. Clearly, a significant portion of the rapid expansion in money has reflected deposit shifts as declining short-term interest rates have reduced the cost of holding checkable deposits. However, currency has begun to grow rapidly. Rising gasoline prices may account for some increased currency use, but some of the acceleration in currency may also reflect an excess supply of money.

Of course, some increasing inflationary pressures should be anticipated once declining oil prices are at an end. Underlying inflationary pressures excluding the influence of fluctuating oil and food prices have remained near 4%. In addition, recent Federal Reserve initiatives have been designed to reduce the dollar's value against other currencies in an effort to stem the erosion in trade balances. Before trade balances can improve, import prices must rise, leading to increasing inflationary pressures, or exports must expand.

Unfortunately, world GNP is slowing substantially. The Japanese economy may grow less than 3% in the current year, while most of Europe also will be growing by 3% or less. In addition, foreign regulatory restraints provide steep thresholds that must be crossed before American exports can significantly penetrate foreign markets. Thus, trade balances have not been able to improve as a result of export expansion. Import substitution resulting from higher import prices remains the only avenue to which acceptable improvements in the trade balances can materialize. (Trade balances also can improve if the United States falls into a recession and reduces imports, but such an adjustment would be unacceptable.)

However, the hourly earnings index was only 2.4% above previous year levels in July and had fallen from the previous month. While an acceleration in that earnings index is anticipated over the next 12 months, current projections

are for a gain of only 2.9% over the previous year by September 1987. Most wage surveys indicate that salary and clerical wages will grow more slowly in 1987 than in 1986. Moreover, recent gains in the stock and bond markets and the increasing concern about creating excessive actuarial surpluses in pension programs will moderate pension contributions. In fact, wage costs per hour worked should grow 3.6% next year, up only modestly from the 3.0% generated this year.

Certainly, productivity could collapse. However, continuing competitive pressures from abroad virtually assure cost-cutting measures in manufacturing. Moreover, recent excesses in retail employment appear to have been related to excessive real estate development. The new tax laws probably will sharply diminish such developments in the next year. Thus, productivity gains approaching 1% can be anticipated in 1987. If so, unit labor costs will expand between 2.5% and 3%.

To be sure, increasing inflationary pressures could intensify wage demands, leading to dramatic increases in the earnings index toward the end of that year. Also, tightening labor market conditions could lead to the hiring of less qualified personnel, causing a slump in productivity. However, both prospects appear to be unlikely at this time.

Therefore, accelerating inflation must come from price markups on labor costs and from prices of raw materials and imported goods. Price markups will be restrained by continuing excess capacity and significant foreign competitive pressures. Raw material prices will rise, as energy and agricultural prices both intensify. However, food inflation is currently projected at slightly more than 4% while prices of raw materials are not expected to grow faster than 6-7%. Finally, prices of imported goods will intensify significantly, but that should be only sufficient to add slightly more than a percentage point to the amount by which inflation exceeds labor costs. Thus, 4% inflation is likely in 1987, but concerns that inflation will rise to 6% or beyond certainly cannot be justified by prevailing economic conditions.

Quarterly Profile of GNP

	<u>1986-2</u>	<u>1986-3</u>	<u>1986-4</u>	<u>1987-1</u>	<u>1987-2</u>	<u>1987-3</u>	<u>1986</u> <u>Annual</u>	<u>1987</u> <u>Annual</u>
Real:	0.6	1.9	3.0	1.9	0.6	1.2	2.5	1.7
Price:	2.5	2.8	3.8	4.2	3.8	3.5	2.9	3.6
Nominal:	3.0	5.0	6.8	6.1	4.5	4.8	5.4	5.4

Monthly Statistical Highlights For August 1986

Payroll employment +192,000; index of hours worked +0.2%; household employment +236,000; civilian unemployment rate 7.0%; personal income +0.5%; savings rate 4.1%; personal consumption +0.7%; retail sales +0.8%; auto sales 11.0 million; housing starts -3.4%; housing permits -5.2%; construction expenditures -0.4%; business inventories +0.1%; orders for durable goods -2.0%; orders for nondefense capital goods +0.6%; industrial production -0.1%; CPI +0.4%; PPI +0.4%; consumption deflator +0.3%; leading indicators +0.3%; real GNP +3.0%; M1 +18.2%; M2 +9.4%.

Monthly Statistical Highlights For September 1986

Payroll employment +148,000; index of hours worked +0.2%; household employment +159,000; civilian unemployment rate 7.0%; personal income +0.4%; savings rate 3.1%; personal consumption +1.4%; retail sales +3.1%; auto sales 12.6 million; housing starts +2.2%; housing permits +0.9%; construction expenditures -0.4%; business inventories -0.1%; orders for durable goods +0.2%; orders for nondefense capital goods +0.2%; industrial production +0.1%; CPI +0.5%; PPI +0.5%; consumption deflator +0.3%; leading indicators +0.3%; real GNP +1.6%; M1 +12.6%; M2 +10.0%.

Commentary

Employment - Strike activity is again distorting employment statistics in August, as USX went on strike during the reference week. A strike at Deere will also restrain employment in the September figures. In addition, initial claims have remained slightly below 400,000, but the pool of insured unemployed has gradually increased. Therefore, an increase in the unemployment rate is expected in August.

Because of continued restraints on wage pressures, our projections of hourly earnings have moderated for the next year.

Personal Income & Outlays - Personal income continues to be distorted by changes in farm subsidies and by some social security payment distortions. In August, farm subsidies are expected to be little changed from July but falling interest rates should lower earnings from property income. On the other hand, wages should rebound.

The auto incentive programs will dramatically reduce personal savings in September, as auto sales are projected to soar to 12.6 million at annual rates in that month. This will create a dramatic surge in retail sales and in consumer outlays. As most of the sales will be coming from inventories, the impact upon GNP will be negligible during the third quarter. However, the reduction in auto inventories may encourage more substantial production schedules in the fourth quarter than would otherwise materialize. These unusually low savings rates are expected to persist for the remainder of this year. Tax changes are anticipated to alter withholding procedures in January, leading to a significant surge in disposable income and in personal savings at that time.

A July surge in housing related retail activity is expected to be shortlived. Unusually dry weather accentuated the purchase of home improvement and furnishing goods. Now that housing activity is beginning to slow, these sales should show less dramatic gains in the months ahead.

Construction - Single family activity has been weaker than anticipated, although the reasons are easily identifiable. Despite lower mortgage rates, a recession in the southwest has effectively paralyzed the Texas housing market. Therefore, single family sales and starts are now expected to show little movement from current levels and to trend slightly downward from earlier gains. This will occur even with further modest easing in mortgage rates. Multiple family activity has not yet weakened substantially, but the changing tax codes unquestionably will sharply restrain multiple construction. Vacancy rates will fall sharply until rental rates rise significantly. This will create multiple starts of less than 550,000 in the second half of 1987. As a result of this

weakness, residential construction is expected to trend downward for the next twelve months.

Also trending downward will be nonresidential construction. Activity already has fallen sharply for office space, but sharp increases in hotel and industrial space prevented any serious falloff in July. While further gains can be anticipated in industrial construction, hotel activity also is excessive. Therefore, weakness should continue at a reduced rate in nonresidential construction over the next eighteen months.

Prices already appear to be responding to the adverse impact of the tax changes. Over the past three months the implicit construction deflator has shown no substantial movement. While some increasing inflationary pressures are expected in the months ahead as a result of rising material and wage costs, the construction deflator will perform at a much lower rate than projected in our forecast.

Business Activity - Sharp gains in defense orders and in orders for commercial aircraft caused a significant rebound in orders for durable goods in July. However, once the aerospace effects are eliminated from the orders, the remainder of manufacturing experienced flat orders in that month. In addition, orders and shipments of household durables slumped in July, suggesting that a flattening of furniture sales will, indeed, materialize. Defense orders almost certainly will be down next month, but prospects for modestly increasing orders for heavy equipment now that import prices are rising could cause further gains in nondefense capital goods. Nevertheless, weakening utilization levels strongly suggest that capital shipments and orders will trend slightly downward next year.

Business inventories should be significantly restrained in the next two months as a result of significant automobile sales. This will not have an appreciable effect upon manufacturers' inventories, however. A more than yearlong liquidation in manufacturing inventories should be coming to an end. Of course, declining inventory prices also may be coming to an end. The speed by which inventories may accumulate now that prices once again are modestly appreciating could be more intense than currently projected. Such a surge in inventory investments would add to economic strength in the next few quarters but also would raise the prospect of an economic slump beyond that period. At the present time, no speculative surge in inventory rebuilding is anticipated.

Prices - As mentioned above, a slight intensifying inflationary outlook is expected over the next few months, even with favorable benefits from sharply declining auto finance costs. This is largely the result of firming oil prices coinciding with a strengthening in livestock prices. However, sharply rising poultry production in the fall should restrain food inflation from intensifying significantly. In addition, oil prices probably will be under downward pressures again after the first of the year. While rising import prices certainly will have an influence upon commodity prices in the United States, wage restraint should hold prices of consumer services to a slightly lower level than contained in the forecast. In general, the prospects for inflation have not changed materially in the past few months.

Miscellaneous - The trade statistics were especially disappointing in July because they continue to include \$1.3 billion of gold transhipped through the United States to Japan while imports were based upon \$12.77 per barrel of oil.

Oil prices now exceed \$15 per barrel, suggesting that imports could rise further in the next few months. Thus, especially high merchandise trade deficits are anticipated during the third quarter.

Financial Markets

Because of the burgeoning trade deficit, the Federal Reserve normally could be anticipated to encourage short-term interest rates downward, leading to further declines in currency values until trade deficits begin to improve. However, current market concerns with inflationary fears may tie the hands of the Federal Reserve. Fortunately, the yield curve has become sufficiently steep to sustain long-term interest rates even without further declines in short-term rates. Moreover, spreads between various classes of long-term instruments have returned to more normal levels. Thus, corporate rates no longer are dramatically away from long-term treasuries. Municipal rates, while slightly high relative to corporate AAA's, also are approaching more realistic spreads, especially in light of the reduced marginal tax rate that will naturally increase the desired yield on tax exempt bonds relative to taxable instruments.

Of course, interest rates could rise significantly if inflationary anticipations begin to generate actual commodity inflation. Under those circumstances, desired inventory holdings could rise, leading to increasing short-term borrowing pressures. However, such an event would be heralded by rising commercial paper rates relative to federal funds. At the present time, commercial paper yields are significantly below yields on federal funds. This suggests that current inflationary concerns are not substantially altering investment behavior. For that reason, yields on long-term maturities should once again begin trending downward as soon as the latest spate state of inflationary fears diminish. There also is a possibility that a further discount rate reduction could be sustained once investors diminish their inflationary concerns.

Equity Markets - Equity markets are apparently anticipating earnings expansion that does not seem to be materializing. Although declining short-term interest rates will reduce financial costs, leading to some improvement in corporate earnings, tax changes will raise tax costs in 1987. Therefore, the net effect upon corporate earnings from these two influences should be minimal.

With interest rates currently rising slightly, equity values are currently vulnerable to a significant retrenchment. In addition, capital gains considerations could lead to significant equity selling during the fall. As a result, equity values could decline by 10-15%. Early in 1987, however, interest rates should again be declining while prospects of improving corporate earnings should be rising. Therefore, the equity markets once again are expected to move forward, ultimately leading to a targeted value of 2200 on the Dow Jones index by the end of that year.

EMPLOYMENT

	Payroll Employment		Index of Hours Worked		Household Civilian Employment		Civilian Unemployment Rate		Hourly Earnings Index	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1986	99783	99783	117.8	117.8	108892	108892	7.1	7.1	168.4	168.4
May	99908	99918	117.7	117.7	109110	109110	7.3	7.3	168.6	168.7
June	99819	99864	117.5	117.3	109673	109673	7.1	7.1	169.4	169.2
July	100223	100253	118.0	117.7	109889	109882	6.9	6.9	169.8	169.0
August	100464	100445*	118.3	117.9*	110016	110118*	6.9	7.0*	170.1	169.6*
September	100705	100593	118.6	118.1	110221	110277	7.0	7.0	170.3	169.9
October	100826	100801	118.7	118.3	110367	110517	7.0	6.9	170.8	170.2
November	100878	101065	118.8	118.6	110456	110808	7.1	6.8	171.3	170.6
December	100963	101254	118.8	118.8	110578	111058	7.1	6.8	171.7	171.0
January 1987	101138	101461	119.0	119.0	110794	111304	7.1	6.8	172.2	171.4
February	101360	101676	119.3	119.2	111053	111500	7.0	6.8	172.6	171.8
March	101585	101788	119.5	119.3	111387	111671	7.0	6.8	173.0	172.3
April	101716	101910	119.7	119.4	111453	111803	7.0	6.9	173.5	172.7
May	101829	102063	119.8	119.5	111548	111946	7.0	6.9	173.9	173.1
June	101960	102118	119.8	119.6	111642	112040	7.0	7.0	174.4	173.6
July	102128	102231	120.0	119.7	111863	112193	7.1	7.0	174.9	174.0
August	102310	102343	120.3	119.8	112016	112334	7.0	7.0	175.4	174.4
September	102492	102533	120.5	120.0	112241	112576	7.0	6.9	176.0	174.9

PERSONAL INCOME

	Personal Income		Wage & Salary		Personal Savings		Disposable Income		Personal Outlays	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1986	3.485	3.489	2.053	2.055	182.4	184.6	2.987	2.988	2.805	2.804
May	3.476	3.484	2.056	2.058	151.6	153.2	2.976	2.980	2.824	2.827
June	3.479	3.486	2.063	2.063	133.2	120.3	2.975	2.977	2.842	2.856
July	3.498	3.503	2.075	2.068	139.2	126.7	2.986	2.990	2.847	2.864
August	3.516	3.521*	2.083	2.081*	137.8	122.4*	2.998	3.006*	2.860	2.884*
September	3.534	3.534	2.092	2.089	135.5	93.8	3.011	3.016	2.876	2.922
October	3.547	3.549	2.100	2.098	136.1	107.0	3.024	3.028	2.888	2.921
November	3.567	3.567	2.108	2.109	131.1	107.2	3.038	3.042	2.907	2.935
December	3.587	3.585	2.116	2.120	127.3	102.5	3.054	3.056	2.928	2.954
January 1987	3.598	3.604	2.126	2.130	154.2	159.4	3.098	3.104	2.944	2.945
February	3.624	3.622	2.138	2.141	172.5	160.1	3.123	3.126	2.951	2.966
March	3.650	3.639	2.150	2.150	188.4	157.0	3.147	3.143	2.959	2.986
April	3.660	3.657	2.158	2.159	176.2	158.5	3.154	3.158	2.978	2.999
May	3.669	3.672	2.167	2.167	165.2	157.4	3.163	3.170	2.998	3.013
June	3.679	3.689	2.176	2.177	153.9	158.3	3.170	3.183	3.017	3.025
July	3.696	3.705	2.186	2.185	150.5	156.7	3.182	3.195	3.032	3.038
August	3.713	3.719	2.197	2.194	149.3	152.3	3.193	3.205	3.044	3.053
September	3.730	3.735	2.208	2.205	149.6	153.4	3.204	3.217	3.055	3.064

Fore. = August Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

CONSUMPTION

	Personal Consumption		Durables		Nondurables		Services		Consumption Real	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1986	2712.0	2710.9	369.7	368.7	920.4	922.3	1421.9	1420.0	2396.1	2395.8
May	2731.0	2733.3	378.9	379.7	925.6	926.9	1426.5	1426.7	2407.6	2410.3
June	2747.3	2761.8	375.4	378.8	931.9	938.3	1439.9	1444.8	2417.3	2424.9
July	2751.8	2768.7	373.8	376.9	927.3	938.4	1450.7	1453.4	2416.0	2427.0*
August	2764.4	2767.4*	379.6	381.9*	927.5	943.0*	1457.3	1462.5*	2420.7	2436.4
September	2779.1	2825.2	383.3	406.1	932.8	947.5	1463.0	1471.6	2425.0	2463.7
October	2790.3	2823.0	379.8	389.7	937.7	952.6	1472.8	1480.7	2426.3	2451.9
November	2808.2	2836.0	381.6	389.6	943.1	956.9	1483.5	1489.5	2433.4	2455.5
December	2828.0	2853.7	384.3	395.0	948.5	960.4	1495.2	1498.3	2442.1	2460.2
January 1987	2843.3	2844.1	388.4	374.2	952.5	964.3	1502.4	1505.6	2449.0	2442.9
February	2849.3	2864.7	384.7	376.8	957.9	970.6	1506.7	1517.3	2447.9	2453.5
March	2857.4	2884.1	383.7	383.2	959.1	975.5	1514.6	1525.4	2446.4	2464.3
April	2875.1	2896.8	385.9	384.2	964.3	978.3	1524.9	1534.3	2453.2	2465.8
May	2894.3	2909.1	388.6	382.0	969.8	983.0	1535.9	1544.1	2461.1	2468.8
June	2912.8	2920.4	392.2	380.9	973.8	985.8	1546.8	1553.7	2468.5	2469.1
July	2926.3	2933.1	393.7	383.0	977.4	988.9	1555.2	1561.2	2471.5	2473.2
August	2937.7	2946.7	391.6	384.3	981.1	992.6	1565.0	1569.8	2472.8	2477.9
September	2947.9	2956.8	388.9	383.5	983.9	995.4	1575.1	1577.9	2473.1	2479.9

RETAIL SALES

	Retail Sales		Non-Auto Durables		Auto (Million Units)		Nondurable Sales		Auto Sales	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1986	117.72	117.72	18.52	18.52	11.0	11.0	72.84	72.84	26.36	26.36
May	118.52	118.68	18.38	18.39	11.3	11.3	73.19	73.12	26.95	27.16
June	118.70	118.60	18.25	18.43	11.0	11.0	73.30	73.37	27.16	26.81
July	118.61	118.09	18.28	18.84	10.9	10.7	73.39	73.50	26.94	26.36
August	119.33	119.65*	18.40	18.86*	11.2	11.0*	73.41	73.80*	27.52	26.99*
September	119.85	123.39	18.65	18.81	11.1	12.6	73.83	74.15	27.37	30.43
October	119.81	121.34	18.86	18.85	10.8	11.2	74.21	74.55	26.74	27.94
November	120.46	121.66	18.89	18.93	10.9	11.0	74.64	74.89	26.93	27.84
December	121.21	122.58	19.03	18.99	11.0	11.4	75.07	75.16	27.11	28.43
January 1987	122.01	120.39	19.14	19.06	11.2	10.2	75.38	75.47	27.49	25.86
February	122.00	121.20	18.93	19.01	11.0	10.5	75.81	75.96	27.26	26.23
March	121.98	122.35	19.14	19.05	10.8	10.8	75.91	76.34	26.93	26.96
April	122.65	122.69	19.17	19.13	10.9	10.8	76.32	76.56	27.16	27.00
May	123.41	122.79	19.31	19.22	11.0	10.6	76.75	76.93	27.35	26.64
June	123.96	122.88	19.36	19.29	11.1	10.5	77.07	77.15	27.53	26.44
July	124.43	123.37	19.46	19.35	11.1	10.6	77.36	77.39	27.61	26.63
August	124.47	123.82	19.26	19.44	11.0	10.6	77.65	77.68	27.56	27.70
September	124.56	124.03	19.21	19.49	10.9	10.5	77.87	77.98	27.48	26.55

Fore. = August Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

CONSTRUCTION

	Housing Starts		Single Family Starts		Housing Permits		Construction Expenditures (Current)		Construction Expenditures (Real)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1986	2 019	2 019	1 242	1 242	1 885	1 885	371.6	371.6	331.8	331.8
May	1 861	1 853	1 247	1 241	1 788	1 788	374.7	374.5	331.6	331.6
June	1 845	1 852	1 223	1 229	1 745	1 792	372.9	374.8	328.3	331.6
July	1 840	1 818	1 215	1 181	1 724	1 754	369.2	376.7	324.4	333.5
August	1 855	1 757*	1 259	1 150*	1 736	1 663*	368.6	375.1*	323.3	330.8*
September	1 858	1 795	1 270	1 173	1 721	1 678	369.8	373.7	323.8	329.0
October	1 826	1 776	1 242	1 165	1 673	1 642	367.3	373.8	320.8	328.5
November	1 815	1 748	1 212	1 142	1 656	1 589	366.5	373.5	319.3	327.6
December	1 804	1 667	1 209	1 079	1 651	1 536	365.7	373.2	317.7	326.5
January 1987	1 793	1 648	1 205	1 092	1 583	1 513	365.0	369.2	316.0	322.2
February	1 770	1 627	1 201	1 085	1 581	1 516	365.3	365.8	315.5	318.4
March	1 746	1 629	1 197	1 103	1 552	1 522	365.3	362.4	314.6	314.6
April	1 725	1 649	1 178	1 116	1 536	1 525	364.9	362.4	313.5	313.8
May	1 740	1 640	1 185	1 107	1 541	1 513	364.3	361.8	312.2	312.4
June	1 701	1 631	1 170	1 094	1 557	1 506	363.8	362.3	310.7	311.8
July	1 695	1 640	1 163	1 102	1 563	1 509	364.6	362.9	310.0	311.5
August	1 704	1 648	1 152	1 105	1 560	1 516	365.5	362.9	309.7	311.0
September	1 700	1 622	1 141	1 086	1 546	1 489	366.9	363.9	309.9	311.0

	Non-Residential		Public Construction		Residential Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1986	133.4	133.4	70.5	70.5	167.8	167.8
May	130.5	130.0	74.4	72.1	169.8	172.5
June	130.7	129.6	73.7	70.9	168.5	174.3
July	126.4	128.9	71.6	72.0	171.2	175.8
August	125.6	128.3*	69.9	71.5*	173.1	175.3*
September	124.9	127.8	69.6	70.8	175.0	175.1
October	124.2	127.5	70.0	71.5	173.1	174.8
November	124.0	127.9	70.7	71.3	171.8	174.3
December	123.8	127.2	71.4	71.8	170.5	174.2
January 1987	123.8	126.3	71.0	72.2	170.2	170.7
February	124.1	126.0	71.3	72.3	169.9	167.5
March	124.1	125.4	71.6	72.5	169.6	164.5
April	124.3	125.1	71.8	73.0	168.8	164.3
May	124.4	124.3	72.1	73.3	167.8	164.2
June	124.5	124.0	72.4	73.7	166.9	164.6
July	125.0	124.2	72.9	74.2	166.7	164.5
August	125.7	124.5	73.3	74.5	166.5	163.9
September	126.5	124.5	73.6	74.8	166.8	164.6

Fore. = August Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

BUSINESS ACTIVITY

	Manufacturers' Inventories		Durable Goods Orders		Non-Defense Capital Goods Orders		Non-Defense Capital Shipments	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1986	279.4	279.4	103.75	103.75	26.18	26.18	27.36	27.36
May	278.4	278.4	102.62	102.62	26.15	26.15	26.58	26.58
June	278.3	278.4	104.77	102.73	26.74	26.42	27.22	27.24
July	278.5	278.3	106.69	106.90	27.16	27.39	27.25	27.36
August	279.0	278.2*	105.36	104.73*	27.42	27.65*	27.34	27.47*
September	279.5	278.5	107.52	104.96	27.36	27.05	27.43	27.53
October	280.3	279.1	107.73	105.58	27.48	27.11	27.47	27.46
November	281.2	279.7	106.96	105.27	27.35	27.13	27.51	27.43
December	282.3	280.5	106.71	105.82	27.26	27.26	27.55	27.52
January 1987	283.5	281.3	107.22	106.43	27.32	27.40	27.50	27.58
February	284.5	282.6	107.89	105.72	27.46	27.09	27.55	27.52
March	285.9	284.1	107.56	104.93	27.43	26.87	27.57	27.36
April	287.1	285.6	107.35	105.13	27.29	26.83	27.53	27.28
May	288.2	286.3	108.41	104.85	27.58	26.59	27.56	27.13
June	289.3	287.4	107.92	104.81	27.53	26.65	27.60	27.05
July	290.8	287.7	107.18	105.43	27.42	26.78	27.67	27.21
August	291.7	288.0	105.93	105.67	27.17	26.88	27.64	27.30
September	293.2	288.9	105.81	106.21	27.12	27.03	27.61	27.39

	Business Inventories		Defense Shipments		Industrial Production		Capacity Utilization	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1986	588.6	588.6	7.33	7.33	125.2	125.2	79.4	79.4
May	586.6	586.7	7.49	7.49	124.7	124.6	78.9	78.8
June	585.5	589.0	7.83	7.96	124.1	124.2	78.3	78.4
July	586.2	589.9*	7.83	8.22	124.3	124.1	78.3	78.2
August	587.0	590.7	7.85	8.15*	124.4	124.0*	78.2	77.9*
September	587.7	590.2	7.60	8.11	124.5	124.2	78.1	77.9
October	589.3	589.6	7.89	8.20	124.8	124.4	78.1	77.9
November	591.4	591.5	8.04	8.29	125.1	124.7	78.1	78.0
December	593.7	593.7	8.15	8.37	125.4	125.0	78.2	78.1
January 1987	596.8	595.3	8.20	8.46	125.7	125.3	78.2	78.1
February	599.2	597.1	8.10	8.41	125.9	125.5	78.2	78.1
March	601.3	599.0	8.22	8.46	126.1	125.7	78.1	78.1
April	603.4	601.4	8.28	8.53	125.9	125.8	77.9	78.0
May	606.2	603.7	8.33	8.60	125.7	125.7	77.6	77.8
June	609.3	606.0	8.39	8.66	125.4	125.5	77.3	77.5
July	611.8	608.1	8.47	8.72	124.8	125.3	76.8	77.2
August	614.7	610.4	8.55	8.76	124.5	125.1	76.6	76.9
September	617.4	613.0	8.63	8.82	124.2	124.9	76.4	76.6

Fore. = August Forecast

C.E. = Current Expectations

* = This item and those beyond it are expectations.

PRICES

	PPI							
	CPI-U		Finished Goods		PPI-Industrial		Estimated GNP	
	(seasonally adjusted)		(seasonally adjusted)		Commodities (unadjusted)		Deflator	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1986	325.4	325.4	286.8	286.8	311.3	311.3	113.5	113.7
May	326.0	326.0	288.6	288.6	311.7	311.7	113.8	114.2
June	327.6	327.6	288.5	288.5	311.6	311.6	114.9	114.6
July	327.6	327.5	287.4	287.4	309.2	308.5	114.7	114.7
August	328.3	328.8*	288.6	288.6*	310.0	310.3*	114.9	115.0
September	329.6	330.1	289.5	289.7	308.1	308.2	115.2	115.3
October	330.5	331.1	290.2	290.4	310.6	310.9	115.5	115.7
November	331.3	332.1	290.9	291.1	310.9	311.5	115.8	116.0
December	332.2	333.4	291.5	292.1	311.3	312.2	116.2	116.5
January 1987	333.3	334.4	292.3	292.8	311.9	312.8	116.5	116.9
February	334.3	335.6	293.1	293.6	312.6	313.5	116.8	117.3
March	335.4	336.3	294.0	293.9	313.3	314.1	117.2	117.6
April	336.5	337.6	295.0	294.8	313.9	314.9	117.6	118.0
May	337.9	338.6	296.2	295.6	314.4	315.5	118.0	118.3
June	339.0	340.0	297.3	296.7	314.9	315.9	118.4	118.8
July	340.0	341.0	298.1	297.5	315.3	316.4	118.8	119.1
August	341.1	342.0	298.8	298.2	316.0	316.8	119.1	119.4
September	342.0	343.1	299.6	298.9	314.6	315.1	119.4	119.7

	Consumption		Consumer		Consumer		Consumer		Implicit	
	Deflator		Durables		Nondurables		Services		Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1986	113.2	113.2	104.4	104.4	105.6	105.5	121.5	121.5	112.0	112.0
May	113.4	113.4	104.9	104.8	105.8	105.8	121.7	121.7	113.0	112.9
June	113.7	113.9	105.1	105.0	106.0	106.1	122.1	122.5	113.6	113.0
July	113.9	114.1*	105.3	105.2*	105.7	105.9*	122.6	122.9*	113.8	113.0
August	114.2	114.4	105.2	105.4	105.7	106.2	123.1	123.3	114.0	113.4*
September	114.6	114.7	105.4	105.4	106.1	106.5	123.5	123.8	114.2	113.6
October	115.0	115.1	105.8	105.7	106.5	106.8	124.0	124.3	114.5	113.8
November	115.4	115.5	106.0	106.0	106.9	107.1	124.5	124.7	114.8	114.0
December	115.8	116.0	106.0	106.2	107.3	107.5	125.0	125.4	115.1	114.3
January 1987	116.1	116.4	106.3	106.4	107.5	107.7	125.4	125.9	115.5	114.6
February	116.4	116.8	106.5	106.6	107.6	108.0	125.9	126.3	115.8	114.9
March	116.8	117.0	106.7	106.8	107.5	108.2	126.3	126.7	116.1	115.2
April	117.2	117.5	106.9	107.1	108.1	108.6	126.9	127.2	116.4	115.5
May	117.6	117.8	107.1	107.3	108.7	108.9	127.5	127.6	116.7	115.8
June	118.0	118.3	107.2	107.5	109.3	109.3	128.0	128.1	117.1	116.2
July	118.4	118.6	107.4	107.6	109.5	109.6	128.5	128.5	117.6	116.5
August	118.8	118.9	107.6	107.9	109.3	109.7	129.1	129.0	118.0	116.7
September	119.2	119.2	107.8	108.1	109.7	109.9	129.6	129.4	118.4	117.0

Fore. = August Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

MISCELLANEOUS

	Merchandise Trade Balance		Leading Indicators		Estimated GNP		Estimated GNP (1982 \$)		IVA (annual rate)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1986	-14.02	-14.28	178.5	178.5	4167	4161	3671	3660	19.6	19.6
May	-14.27	-13.12	178.8	177.9	4173	4179	3667	3659	2.8	2.8
June	-12.46	-13.25	179.2	177.5	4207	4199	3661	3664	-7.7	-1.7
July	-13.66	-18.04p	179.6	179.4	4218	4211	3677	3671	-1.3	7.8
August	-12.93	-17.09*	179.9	179.9*	4235	4232	3686	3680	15.8	13.6
September	-13.88	-15.56	180.3	180.4	4244	4249	3684	3685	22.7	10.2
October	-13.59	-15.92	180.1	180.1	4271	4273	3698	3693	10.3	4.3
November	-13.22	-15.27	180.3	179.6	4293	4305	3707	3711	-7.6	-1.2
December	-12.67	-15.58	180.6	179.9	4316	4326	3714	3713	-18.7	-4.7
January 1987	-13.78	-15.03	180.2	180.3	4342	4347	3727	3719	-7.8	-6.6
February	-13.11	-15.29	180.0	180.6	4363	4366	3735	3722	-5.1	-8.3
March	-12.65	-15.42	180.5	180.5	4384	4384	3741	3728	-3.0	-5.9
April	-14.06	-16.05	180.2	180.0	4401	4397	3742	3726	-1.6	-4.6
May	-12.93	-14.17	179.6	179.3	4418	4415	3744	3732	-1.4	-5.3
June	-13.01	-14.20	179.2	178.7	4435	4429	3746	3728	-2.4	-5.6
July	-14.93	-15.23	178.6	178.5	4454	4447	3749	3733	-5.3	-6.2
August	-13.02	-13.36	178.8	178.8	4474	4467	3757	3741	-6.7	-6.6
September	-12.24	-12.82	179.2	179.1	4494	4483	3764	3745	-8.1	-7.1

Fore. = August Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

FINANCIAL MARKETS

	Monetary Base		M1		M2		Federal Funds		T-Bills (6 Mos.)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1986	239.9	239.9	646.1	646.1	2621.6	2622.5	6.99	6.99	6.08	6.08
May	242.3	242.3	658.6	658.7	2647.0	2649.7	6.85	6.85	6.19	6.19
June	244.2	244.2	666.3	666.8	2667.3	2670.7	6.92	6.92	6.27	6.27
July	245.6	245.7	673.7	676.1	2685.0	2698.5	6.52	6.56	5.85	5.86
August	247.2	247.0*	679.6	685.6*	2702.5	2718.7*	6.36	6.22*	5.79	5.43*
September	248.8	248.6	686.1	692.4	2720.9	2740.4	6.32	5.82	5.81	5.41
October	250.3	250.2	689.1	698.1	2735.4	2759.6	6.48	5.51	5.93	5.35
November	251.9	251.8	694.2	703.0	2749.6	2776.2	6.59	5.36	6.07	5.19
December	253.5	253.2	699.3	706.9	2763.5	2791.6	6.52	5.33	6.06	5.11
January 1987	255.2	254.7	704.6	711.4	2784.7	2809.4	6.41	5.24	5.91	5.06
February	256.9	256.2	710.3	716.3	2806.5	2826.3	6.22	5.36	5.79	5.11
March	258.6	257.9	715.4	721.3	2829.2	2846.0	6.51	5.51	5.94	5.22
April	260.3	259.5	718.4	725.8	2843.6	2863.8	6.69	5.44	6.01	5.20
May	262.1	261.3	722.9	730.6	2861.7	2880.7	6.78	5.52	6.04	5.27
June	263.9	263.1	727.4	735.4	2880.7	2897.9	6.87	5.46	6.04	5.24
July	265.3	264.8	733.0	740.6	2898.3	2915.3	6.45	5.39	5.83	5.18
August	266.4	266.3	737.7	745.1	2915.2	2929.9	6.40	5.47	5.80	5.28
September	267.5	267.9	740.6	749.6	2927.0	2944.6	6.42	5.58	5.80	5.39

	Aaa (Seasoned)		Municipals (Bond Buyer)		(3 Month) Commercial Paper		90 Day CD's		Prime Rate	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1986	8.79	8.79	7.20	7.20	6.60	6.60	6.60	6.60	8.83	8.83
May	9.09	9.09	7.54	7.54	6.62	6.62	6.65	6.65	8.50	8.50
June	9.13	9.13	7.87	7.87	6.71	6.71	6.73	6.73	8.50	8.50
July	8.94	8.88	7.69	7.51	6.43	6.33	6.47	6.37	8.14	8.16
August	8.83	8.67*	7.59	7.17*	6.26	5.81*	6.34	5.80*	8.00	7.97*
September	8.77	8.35	7.47	6.78	6.21	5.26	6.30	5.29	8.00	7.50
October	8.89	8.17	7.51	6.62	6.53	5.11	6.63	5.20	8.00	7.13
November	9.03	7.96	7.68	6.44	6.62	5.00	6.72	5.16	8.00	7.00
December	9.20	7.99	7.85	6.47	6.55	5.03	6.65	5.10	8.00	7.00
January 1987	8.99	7.95	7.64	6.45	6.36	4.89	6.47	4.93	8.00	7.00
February	8.52	8.07	7.17	6.58	6.17	5.13	6.28	5.17	8.00	7.00
March	8.46	8.23	7.08	6.73	6.53	5.27	6.64	5.34	8.00	7.00
April	8.69	8.20	7.30	6.70	6.74	5.35	6.83	5.42	8.00	7.00
May	8.92	8.29	7.49	6.80	6.83	5.47	6.94	5.53	8.50	7.00
June	8.86	8.25	7.44	6.77	6.95	5.45	7.13	5.60	8.50	7.00
July	8.73	8.21	7.27	6.75	6.42	5.46	6.61	5.55	8.50	7.00
August	8.59	8.43	7.13	6.99	6.37	5.53	6.52	5.64	8.50	7.13
September	8.55	8.50	7.05	7.07	6.35	5.65	6.47	5.77	8.50	7.50

Fore. = August Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

Georgia State University

a unit of the university system of georgia

university plaza
atlanta, georgia 30303-3083

college of business administration
economic forecasting center
404/658-3282

MONTHLY PROJECTIONS September 1986

Dr. Donald Ratajczak, Director
For Release: October 6, 1986

SOLID GROWTH REMAINS ELUSIVE

Trade improved substantially in the August reports, reflecting reduced manufacturing purchases following a dramatic surge in July. As oil imports fell to 218 million barrels and as the price of oil in August declined to \$11.97, imports in subsequent months almost certainly will rebound. Therefore, the August improvement in trade provides little reason to believe that trade balances will be improving in the remainder of the year.

Indeed, the employment situation for September strongly suggests that the economy is virtually stalled. Strike activity removed nearly 30,000 jobs from the machinery sector, but manufacturing employment probably would have been unchanged even if walkouts had not intensified. Oil and gas exploration continued to dip modestly while construction activity appears to have reached an upper limit for this cycle. In short, in the absence of any significant improvement in trade relationships, the goods producing sector of the economy will provide no new jobs for the remainder of this year. As tax reform will significantly increase the costs of carrying construction inventories, a substantial construction inventory correction will develop in 1987. This means that the construction outlays should begin falling sharply before the end of 1986. Much of the weakness will be concentrated in lodging, rental properties, and commercial building. In the absence of significant improvement in trade relations, employment opportunities in goods producing industries will be falling in 1987 as a result of the construction slump.

Through most of this economic expansion, the service sector has been more than offsetting the goods producing sector. However, employment trends suggest that little further gains are developing in the transportation and communications sectors. Wholesale trade also has flattened. Retail trade continues to move significantly forward, as back-to-school sales were stronger than anticipated, auto incentives are generating more auto sales than had been expected, and eateries continue to expand aggressively. The financial sector also appears to be growing vigorously. However, real estate brokers no longer are growing, while business services are expanding at a slowing rate. On balance, the weakness in goods producing activity during 1987 will be accompanied by more modest gains in service payrolls than in the current year. While

no recession appears to be developing, economic growth almost certainly will be slower in 1987 than in 1986.

Anyone concerned about researching inflation must consider who will be the income-gaining beneficiaries of these inflationary surges. Obviously, with the hourly earnings index at a cyclical low year-over-year rate of 2.0% in September, workers will not be experiencing accelerating incomes. At the current rate of wage cost expansion, unit labor costs in 1987 could expand less rapidly than in 1986. Although interest recipients could increase their earnings in an inflationary environment, it is unlikely that any inflationary surge would quickly be passed along to debt-holders. More likely, interest earnings will grow about the same rate in 1987 as in 1986. Thus, any intensifying inflation must be reflected in improved profit margins and a significant expansion in corporate profitability. However, foreign competition will prevent any significant margin enhancements from developing in goods producing industries. While the inventory correction in construction will begin to encourage higher rental values (rents may ultimately rise between 15 and 20% to replace the tax benefits previously received by real estate owners by improved rental income, only a small amount of rental enhancements will be possible in 1987, when construction product inventories will be especially excessive.) Profit enhancements in other service-related industries do not appear to be significant.

In other words, concerns that inflation will rebound dramatically in 1987 simply cannot be rectified with realistic income and expenditures flows. Of course, inflation will temporarily rebound to more than 5% in the next few months as higher oil prices and then higher prices for automobiles are captured by the price indices. However, these price gains are one-time events that will not significantly alter underlying inflationary pressures.

Quarterly Profile of GNP

	<u>1986-2</u>	<u>1986-3</u>	<u>1986-4</u>	<u>1987-1</u>	<u>1987-2</u>	<u>1987-3</u>	<u>1986</u> <u>Annual</u>	<u>1987</u> <u>Annual</u>
Real:	0.6	1.7	2.0	1.8	1.4	1.2	2.4	1.6
Price:	1.8	2.8	3.2	3.5	3.5	4.1	2.7	3.4
Nominal:	2.5	4.6	5.3	5.4	5.0	5.4	5.2	5.0

Monthly Statistical Highlights For September 1986

Personal income +0.4%; savings rate 2.6%; personal consumption +1.0%; retail sales +3.9%; auto sales 15.5 million; housing starts -1.9%; housing permits -3.6%; construction expenditures +0.1%; business inventories -0.2%; orders for durable goods +0.8%; orders for nondefense capital goods +1.7%; industrial production +0.1%; CPI +0.4%; PPI +0.3%; consumption deflator +0.3%; leading indicators +0.2%; real GNP +1.6%; M1 +11.6%; M2 +8.2%.

Monthly Statistical Highlights For October 1986

Payroll employment +170,000; index of hours worked +0.2%; household employment +178,000; civilian unemployment rate 7.0%; personal income +0.5%; savings rate 4.0%; personal consumption -0.1%; retail sales -3.8%; auto sales 10.2 million; housing starts -2.8%; housing permits -3.3%; construction expenditures -0.2%; business inventories +0.2%; orders for durable goods +0.6%; orders for nondefense capital goods +1.1%; industrial production +0.2%; CPI +0.4%; PPI +0.5%; consumption deflator +0.3%; leading indicators +0.1%; real GNP +1.0%; M1 +7.1%; M2 +7.1%.

Commentary

Employment - Although the manufacturing workweek remained unchanged in September, most of the employment statistics showed considerable weakness. Not only did the unemployment rate rise by 0.2 percentage points, but payroll employment increased by only 105,000. The 150,000 gain in service activities reflected a 30,000 increase as a result of a strike ending at NYNEX. Of course, much of the manufacturing weakness reflected strike activity in the machinery and primary metals industries. Excluding strike considerations, payrolls would have been unchanged in manufacturing during September. Because of weakness in durable manufacturing, continued weakness in oil exploration, and no significant rebound in construction, industrial production will not increase in September.

Apparently, seasonal factors are failing to capture a shift in the work habits of young females: More are entering the workforce in June than anticipated in the seasonals. More are leaving in September than the seasonals expect as the pool of females entering higher education continues to rise. This results in a reduction in the unemployment rate during June followed by an increase in September. However, employment weakness in September was more widespread than suggested by seasonal distortions alone.

Employment statistics also indicate that wage pressures remain absent. The hourly earnings index was up only 2.0% from the previous year, which is the lowest year-over-year increase during this cycle.

Personal Income and Outlays - August estimates of outlays captured increases in automobile sales that were not readily apparent in the retail sales statistics. As a result, retail sales probably will experience a significant upward revision in August. If this develops, the percentage change announced for September will be smaller than the 3.9% currently expected. With further auto sales occurring in September, it appears that the savings rate will reach an unusually low 2.6% in that month. Sales are then expected to plummet in October and November after the financing incentives lapse on October 8.

The weakness in personal income despite upward revisions in wage and salary gains reflects lower increases in property income and in farm subsidies than originally projected. Relatively low interest rates will continue to contain interest earnings.

Construction - Weakness in single-family sales, especially in the northeast, suggest that single-family activity will be lower in the next year than originally projected. Tax reform also will cause a significant slowing in rental properties. In effect, the removal of tax benefits from real estate ownership requires an offsetting shift in rental income to justify maintaining real estate in investment portfolios. Somewhere between 15 and 20% gains in rental values will be necessary to replace the tax benefits that are being lost. However, excess inventory of construction products will prevent any rental increases from developing until those inventories fall toward desired levels. Under tax reform, desired inventory is expected to fall below 10% for commercial space and to decline to 4% for rental properties. In order to achieve these vacancies, construction will need to fall to 500,000 rental units for 2 years to eliminate the 7.3% current vacant rate. Commercial construction will need to fall to 180 million square-feet from a peak of 345 million in 1985 and to persist near that level for nearly 4 years to achieve the desired vacancy rate. This construction slump will be the major casualty caused by the tax reform program.

On the other hand, prices of construction products will continue to increase more slowly than other prices until the excess inventory has been eliminated.

Business Activity - Excluding transportation equipment, orders for durable goods have essentially been flat for the entire year. With capacity utilization projected to decline modestly over the next 12 months, orders for nondefense capital goods should gradually ease. Defense orders and shipments will continue to grow. Shipments of nondefense capital goods are expected to show little change in the next year.

As automobile inventories are being sold off, business inventories should fall sharply through September. Because sales have been more vigorous than anticipated, inventories will have fallen below desired levels relative to recent sales. As a result, production of automobiles should intensify significantly during the fourth quarter. However, sales are expected to weaken dramatically, leading to other automobile incentives in 1987.

Prices - A flare up of inflationary pressure is being generated by increasing oil and automobile prices. In the absence of any further production restraints by OPEC, this accelerating inflationary force should dissipate before the end of this year. Relatively modest wage increases should prevent service prices from growing as rapidly as projected in our August forecast. Tax reform uncertainties should restrain price increases for construction goods. As a result, inflation should be slightly less than projected in August.

Miscellaneous - Merchandise trade balances fell sharply in August after being revised down from a previous record in July. While some analysts have hailed this as the beginning of a significant improvement in America's trade balances, the evidence does not warrant this conclusion. Exports continue to show no gains, although the 0.6% decline in exports during August reflect the absence of further nonmonetary gold shipments to Japan. Imports were held down by further declining oil prices. By October, the price of oil delivered to the United States will be more than \$16 per barrel. This will be up more than four dollars from the \$11.97 per barrel at which oil was delivered in August. In addition, early Christmas orders accounted for much of the July spurt in imports.

Financial Markets

The Federal Reserve has indicated that it will accommodate money demand at prevailing Federal funds rates. As a result, no significant increase in Federal funds rate should be anticipated for the remainder of this year. Such accommodation means that arbitrage potential exists if dealers are willing to hold significant inventories of long bonds. Of course, if the Federal Reserve accommodation led to dramatic increases in inflationary prospects, a steep yield curve would be justified and sustainable, at least until the rising inflationary pressures led to increasing credit market pressures. However, the inflationary fallout from current Federal Reserve policy appears to be relatively modest. Although the money stock has grown dramatically, currency growth has been much more sedate. Most of the growth in checkable deposits is the result of a decline in the interest rate differential between yields on checkable deposits and yields on alternative investments. Now that those yields are about to stabilize, more modest growth is anticipated for checkable deposits in the months ahead.

One short-term concern about interest rates is the investment demand by the Japanese investor over the next few months. Because of the distribution of the Hirohito commemorative coin, Japanese savings will be absorbed by gold purchases into November. This suggests that foreign investor support for the next quarterly funding program by the Treasury Department will be relatively sparse. Therefore, a significant increase in long-term interest rates is possible. However, economic weakness should sharply reduce credit market pressures early in 1987, possibly leading to another decline in the prime and discount rates. For the end of 1987, however, the low point on interest rates for this decade will have been passed and rates will be trending upward.

Equity Markets - In general, the outlook is for similar long-term interest rates to those anticipated in our August forecast. However, economic growth is decidedly slower and the returns on capital will be less over the next six months than projected in the August forecast. With somewhat lower earnings prospects and no significant alteration in interest rates, equity values probably would fall. Because of selling by investors with significant capital gains, a decline in equity values already was anticipated toward the end of 1986. It now appears that a stock market decline in the vicinity of 1625 as measured on the Dow Jones index is likely toward the end of this year or early in 1987. A further loosening of interest rates in 1987 should lead to a modestly rising stock market in that year. The Dow Jones index could exceed 2100 before the end of 1987.

EMPLOYMENT

	Payroll Employment		Index of Hours Worked		Household Civilian Employment		Civilian Unemployment Rate		Hourly Earnings Index	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1986	99783	99783	117.8	117.8	108892	108892	7.1	7.1	168.4	168.4
May	99908	99918	117.7	117.7	109110	109110	7.3	7.3	168.6	168.7
June	99819	99843	117.5	117.3	109673	109673	7.1	7.1	169.4	169.2
July	100223	100122	118.0	118.0	109889	109882	6.9	6.9	169.8	168.8
August	100464	100324	118.3	118.6	110016	110155	6.9	6.8	170.1	169.2
September	100705	100549*	118.6	118.8*	110221	110405*	7.0	6.8*	170.3	169.7*
October	100826	100719	118.7	119.0	110367	110583	7.0	6.8	170.8	170.2
November	100878	100990	118.8	119.3	110456	110876	7.1	6.7	171.3	170.6
December	100963	101168	118.8	119.5	110578	111081	7.1	6.7	171.7	171.0
January 1987	101138	101440	119.0	119.7	110794	111374	7.1	6.6	172.2	171.5
February	101360	101643	119.3	119.9	111053	111605	7.0	6.6	172.6	171.9
March	101585	101839	119.5	120.1	111387	111823	7.0	6.6	173.0	172.3
April	101716	101949	119.7	120.1	111453	111937	7.0	6.6	173.5	172.7
May	101829	102051	119.8	120.2	111548	112006	7.0	6.8	173.9	173.0
June	101960	102247	119.8	120.3	111642	112254	7.0	6.8	174.4	173.5
July	102128	102442	120.0	120.5	111863	112480	7.1	6.8	174.9	174.0
August	102310	102612	120.3	120.7	112016	112665	7.0	6.8	175.4	174.4
September	102492	102884	120.5	121.0	112241	112974	7.0	6.7	176.0	174.9

PERSONAL INCOME

	Personal Income		Wage & Salary		Personal Savings		Disposable Income		Personal Outlays	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1986	3.485	3.487	2.053	2.055	182.4	183.3	2.987	2.986	2.805	2.803
May	3.476	3.487	2.056	2.058	151.6	152.3	2.976	2.977	2.824	2.825
June	3.479	3.482	2.063	2.063	133.2	123.7	2.975	2.972	2.842	2.848
July	3.498	3.493	2.075	2.070	139.2	118.4	2.986	2.979	2.847	2.861
August	3.516	3.505	2.083	2.082	137.8	93.7	2.998	2.987	2.860	2.893
September	3.534	3.522*	2.092	2.093*	135.5	78.8*	3.011	3.000*	2.876	2.922*
October	3.547	3.540	2.100	2.105	136.1	120.9	3.024	3.015	2.888	2.894
November	3.567	3.558	2.108	2.116	131.1	137.6	3.038	3.029	2.907	2.891
December	3.587	3.575	2.116	2.127	127.3	126.6	3.054	3.046	2.928	2.919
January 1987	3.598	3.588	2.126	2.138	154.2	145.8	3.098	3.078	2.944	2.932
February	3.624	3.606	2.138	2.148	172.5	163.8	3.123	3.097	2.951	2.933
March	3.650	3.623	2.150	2.158	188.4	141.7	3.147	3.111	2.959	2.969
April	3.660	3.637	2.158	2.165	176.2	142.1	3.154	3.123	2.978	2.981
May	3.669	3.651	2.167	2.172	165.2	137.4	3.163	3.137	2.998	3.000
June	3.679	3.667	2.176	2.182	153.9	135.0	3.170	3.149	3.017	3.014
July	3.696	3.684	2.186	2.193	150.5	139.8	3.182	3.166	3.032	3.026
August	3.713	3.702	2.197	2.204	149.3	139.8	3.193	3.181	3.044	3.041
September	3.730	3.722	2.208	2.217	149.6	142.0	3.204	3.198	3.055	3.056

Fore. = August Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

CONSUMPTION

	Personal Consumption		Durables		Nondurables		Services		Consumption Real	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1986	2712.0	2710.5	369.7	368.5	920.4	922.1	1421.9	1419.9	2396.1	2396.1
May	2731.0	2731.7	378.9	379.0	925.6	926.6	1426.5	1426.1	2407.6	2410.3
June	2747.3	2753.8	375.4	374.2	931.9	936.4	1439.9	1443.3	2417.3	2418.9
July	2751.8	2765.8	373.8	375.8	927.3	937.7	1450.7	1452.3	2416.0	2427.2
August	2764.4	2797.1	379.6	402.7	927.5	939.8	1457.3	1454.7	2420.7	2453.2*
September	2779.1	2824.6*	383.3	417.3*	932.8	945.0*	1463.0	1462.3*	2425.0	2471.5
October	2790.3	2796.1	379.8	376.0	937.7	949.4	1472.8	1470.7	2426.3	2437.0
November	2808.2	2792.5	381.6	359.8	943.1	953.6	1483.5	1479.1	2433.4	2425.1
December	2828.0	2819.6	384.3	370.9	948.5	958.2	1495.2	1490.5	2442.1	2441.1
January 1987	2843.3	2831.4	388.4	367.6	952.5	964.4	1502.4	1499.4	2449.0	2444.7
February	2849.3	2857.9	384.7	381.9	957.9	967.3	1506.7	1508.7	2447.9	2462.0
March	2857.4	2866.6	383.7	378.8	959.1	971.4	1514.6	1516.4	2446.4	2462.5
April	2875.1	2877.3	385.9	376.4	964.3	976.0	1524.9	1524.9	2453.2	2464.1
May	2894.3	2895.1	388.6	380.8	969.8	980.1	1535.9	1534.2	2461.1	2470.6
June	2912.8	2908.7	392.2	380.6	973.8	985.1	1546.8	1543.0	2468.5	2474.5
July	2926.3	2920.1	393.7	378.9	977.4	989.7	1555.2	1551.5	2471.5	2474.6
August	2937.7	2934.2	391.6	380.6	981.1	993.0	1565.0	1560.6	2472.8	2478.4
September	2947.9	2948.1	388.9	382.4	983.9	996.1	1575.1	1569.6	2473.1	2481.1

RETAIL SALES

	Retail Sales		Non-Auto Durables		Auto (Million Units)		Nondurable Sales		Auto Sales	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1986	117.72	117.72	18.52	18.52	11.0	11.0	72.84	72.84	26.36	26.36
May	118.52	118.68	18.38	18.39	11.3	11.3	73.19	73.12	26.95	27.16
June	118.70	118.96	18.25	18.50	11.0	11.1	73.30	73.36	27.16	27.10
July	118.61	119.26	18.28	18.85	10.9	10.7	73.39	73.38	26.94	27.03
August	119.33	120.18	18.40	18.79	11.2	12.7	73.41	73.48	27.52	27.91
September	119.85	124.84*	18.65	18.89*	11.1	15.5*	73.83	73.89*	27.37	32.06*
October	119.81	120.13	18.86	18.95	10.8	10.2	74.21	74.23	26.74	26.95
November	120.46	118.48	18.89	19.06	10.9	8.6	74.64	74.56	26.93	24.86
December	121.21	120.20	19.03	19.15	11.0	9.7	75.07	74.92	27.11	26.13
January 1987	122.01	120.28	19.14	18.87	11.2	9.5	75.38	75.40	27.49	26.01
February	122.00	122.25	18.93	18.86	11.0	10.9	75.81	75.63	27.26	27.76
March	121.98	122.20	19.14	18.93	10.8	10.6	75.91	75.95	26.93	27.32
April	122.65	122.26	19.17	18.99	10.9	10.3	76.32	76.31	27.16	26.96
May	123.41	123.12	19.31	19.06	11.0	10.6	76.75	76.63	27.35	27.43
June	123.96	123.49	19.36	19.21	11.1	10.5	77.07	77.02	27.53	27.26
July	124.43	123.64	19.46	19.17	11.1	10.4	77.36	77.38	27.61	27.09
August	124.47	124.10	19.26	19.15	11.0	10.5	77.65	77.64	27.56	27.31
September	124.56	124.56	19.21	19.20	10.9	10.6	77.87	77.88	27.48	27.48

Fore. = August Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

CONSTRUCTION

	Housing Starts		Single Family Starts		Housing Permits		Construction Expenditures (Current)		Construction Expenditures (Real)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1986	2.019	2.019	1.242	1.242	1.885	1.885	371.6	373.9	331.8	334.0
May	1.861	1.853	1.247	1.241	1.788	1.788	374.7	374.5	331.6	332.0
June	1.845	1.852	1.223	1.230	1.745	1.792	372.9	375.4	328.3	332.6
July	1.840	1.815	1.215	1.162	1.724	1.759	369.2	378.1	324.4	335.2
August	1.855	1.822	1.259	1.197	1.736	1.654	368.6	382.2	323.3	338.1
September	1.858	1.788*	1.270	1.186*	1.721	1.595*	369.8	382.3*	323.8	337.4*
October	1.826	1.738	1.242	1.152	1.673	1.543	367.3	381.5	320.8	336.1
November	1.815	1.699	1.212	1.126	1.656	1.511	366.5	380.9	319.3	334.7
December	1.804	1.647	1.209	1.083	1.651	1.466	365.7	377.2	317.7	330.6
January 1987	1.793	1.594	1.205	1.056	1.583	1.417	365.0	373.1	316.0	326.4
February	1.770	1.590	1.201	1.063	1.581	1.426	365.3	370.2	315.5	323.6
March	1.746	1.609	1.197	1.084	1.552	1.442	365.3	366.8	314.6	320.1
April	1.725	1.616	1.178	1.102	1.536	1.465	364.9	364.9	313.5	317.6
May	1.740	1.580	1.185	1.078	1.541	1.443	364.3	365.1	312.2	316.9
June	1.701	1.558	1.170	1.056	1.557	1.427	363.8	365.3	310.7	316.3
July	1.695	1.602	1.163	1.085	1.563	1.443	364.6	364.9	310.0	315.4
August	1.704	1.630	1.152	1.107	1.560	1.449	365.5	365.1	309.7	315.0
September	1.700	1.617	1.141	1.089	1.546	1.461	366.9	366.7	309.9	315.6

	Non-Residential		Public Construction		Residential Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1986	133.4	132.8	70.5	70.6	167.8	170.5
May	130.5	130.1	74.4	71.9	169.8	172.5
June	130.7	130.1	73.7	70.8	168.5	174.5
July	126.4	129.8	71.6	72.5	171.2	175.9
August	125.6	131.9	69.9	73.6	173.1	176.7
September	124.9	132.2*	69.6	73.5*	175.0	176.6*
October	124.2	131.7	70.0	73.7	173.1	176.1
November	124.0	131.6	70.7	74.0	171.8	175.3
December	123.8	130.5	71.4	73.8	170.5	172.9
January 1987	123.8	129.3	71.0	73.5	170.2	170.3
February	124.1	129.0	71.3	73.9	169.9	167.3
March	124.1	127.8	71.6	74.0	169.6	165.0
April	124.3	125.9	71.8	74.3	168.8	164.7
May	124.4	125.2	72.1	74.6	167.8	165.3
June	124.5	125.0	72.4	74.9	166.9	165.4
July	125.0	125.1	72.9	75.3	166.7	164.5
August	125.7	125.3	73.3	75.5	166.5	164.3
September	126.5	125.6	73.6	75.8	166.8	165.3

Fore. = August Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

BUSINESS ACTIVITY

	Manufacturers' Inventories		Durable Goods Orders		Non-Defense Capital Goods Orders		Non-Defense Capital Shipments	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1986	279.4	279.4	103.75	103.75	26.18	26.18	27.36	27.36
May	278.4	278.4	102.62	102.62	26.15	26.15	26.58	26.58
June	278.3	278.4	104.77	102.73	26.74	26.42	27.22	27.24
July	278.5	278.6	106.69	106.22	27.16	27.39	27.25	27.42
August	279.0	278.1	105.36	102.89	27.42	26.29	27.34	27.27
September	279.5	277.8*	107.52	103.76*	27.36	26.73*	27.43	27.16*
October	280.3	278.5	107.73	104.43	27.48	27.02	27.47	27.21
November	281.2	279.3	106.96	103.72	27.35	26.84	27.51	27.13
December	282.3	280.2	106.71	103.59	27.26	26.59	27.55	27.04
January 1987	283.5	281.1	107.22	102.88	27.32	26.38	27.50	26.89
February	284.5	281.9	107.89	104.15	27.46	26.53	27.55	26.97
March	285.9	282.7	107.56	104.86	27.43	26.82	27.57	26.93
April	287.1	283.5	107.35	105.43	27.29	27.04	27.53	27.13
May	288.2	284.1	108.41	105.71	27.58	27.21	27.56	27.20
June	289.3	285.1	107.92	105.40	27.53	26.89	27.60	27.23
July	290.8	286.0	107.18	105.53	27.42	26.95	27.67	27.26
August	291.7	286.9	105.93	106.04	27.17	27.12	27.64	27.35
September	293.2	287.7	105.81	106.09	27.12	27.11	27.61	27.31

	Business Inventories		Defense Shipments		Industrial Production		Capacity Utilization	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1986	588.6	588.6	7.33	7.33	125.2	124.7	79.4	79.5
May	586.6	586.7	7.49	7.49	124.7	124.2	78.9	79.1
June	585.5	588.9	7.83	7.96	124.1	124.2	78.3	78.9
July	586.2	591.3	7.83	8.08	124.3	124.6	78.3	79.1
August	587.0	590.8*	7.85	7.51	124.4	124.8	78.2	79.0
September	587.7	589.7	7.60	7.84*	124.5	124.9*	78.1	78.9*
October	589.3	590.6	7.89	7.96	124.8	125.1	78.1	78.9
November	591.4	592.4	8.04	8.01	125.1	125.4	78.1	79.0
December	593.7	594.3	8.15	8.04	125.4	125.6	78.2	79.0
January 1987	596.8	596.6	8.20	8.16	125.7	125.7	78.2	78.8
February	599.2	598.7	8.10	8.23	125.9	125.8	78.2	78.7
March	601.3	601.2	8.22	8.26	126.1	126.0	78.1	78.7
April	603.4	603.1	8.28	8.32	125.9	125.8	77.9	78.4
May	606.2	604.7	8.33	8.35	125.7	125.7	77.6	78.1
June	609.3	607.1	8.39	8.48	125.4	125.8	77.3	78.0
July	611.8	609.2	8.47	8.59	124.8	126.0	76.8	78.0
August	614.7	611.2	8.55	8.68	124.5	126.1	76.6	77.9
September	617.4	613.6	8.63	8.50	124.2	126.3	76.4	77.9

Fore. = August Forecast

C.E. = Current Expectations

* = This item and those beyond it are expectations.

PRICES

	CPI-U		PPI		PPI-Industrial		Estimated GNP	
	(seasonally adjusted)		(seasonally adjusted)		Commodities (unadjusted)		Deflator	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1986	325.4	325.4	286.8	286.8	311.3	311.6	113.5	113.7
May	326.0	326.0	288.6	288.6	311.7	311.7	113.8	114.2
June	327.6	327.5	288.5	288.5	311.6	311.6	114.9	114.5
July	327.6	327.6	287.4	287.3	309.2	308.5	114.7	114.7
August	328.3	328.2	288.6	288.3	310.0	307.7	114.9	114.7
September	329.6	329.5*	289.5	289.2*	308.1	306.0*	115.2	114.9
October	330.5	330.8	290.2	290.6	310.6	309.1	115.5	115.4
November	331.3	332.0	290.9	291.8	310.9	310.0	115.8	115.8
December	332.2	333.0	291.5	292.5	311.3	310.6	116.2	116.0
January 1987	333.3	333.9	292.3	293.0	311.9	311.1	116.5	116.4
February	334.3	334.8	293.1	293.6	312.6	311.9	116.8	116.7
March	335.4	335.8	294.0	294.3	313.3	312.4	117.2	117.0
April	336.5	336.9	295.0	295.1	313.9	313.0	117.6	117.3
May	337.9	338.0	296.2	295.8	314.4	313.7	118.0	117.8
June	339.0	338.9	297.3	296.2	314.9	314.1	118.4	118.1
July	340.0	340.1	298.1	297.0	315.3	315.3	118.8	118.5
August	341.1	341.2	298.8	297.6	316.0	315.6	119.1	118.9
September	342.0	342.3	299.6	298.3	314.6	313.5	119.4	119.3

	Consumption		Consumer		Consumer		Consumer		Implicit	
	Deflator		Durables		Nondurables		Services		Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1986	113.2	113.1	104.4	104.4	105.6	105.5	121.5	121.4	112.0	112.0
May	113.4	113.3	104.9	104.8	105.8	105.8	121.7	121.6	113.0	112.8
June	113.7	113.8	105.1	104.9	106.0	106.1	122.1	122.3	113.6	112.9
July	113.9	114.0	105.3	105.1	105.7	106.1	122.6	122.5	113.8	112.8
August	114.2	114.0*	105.2	105.2*	105.7	106.1*	123.1	122.8*	114.0	113.0
September	114.6	114.3	105.4	105.3	106.1	106.5	123.5	123.1	114.2	113.3*
October	115.0	114.7	105.8	105.5	106.5	106.7	124.0	123.5	114.5	113.5
November	115.4	115.2	106.0	105.8	106.9	107.0	124.5	123.9	114.8	113.8
December	115.8	115.5	106.0	106.0	107.3	107.3	125.0	124.4	115.1	114.1
January 1987	116.1	115.8	106.3	106.2	107.5	107.5	125.4	124.8	115.5	114.3
February	116.4	116.1	106.5	106.4	107.6	107.6	125.9	125.3	115.8	114.4
March	116.8	116.4	106.7	106.7	107.5	107.8	126.3	125.7	116.1	114.6
April	117.2	116.8	106.9	106.9	108.1	108.0	126.9	126.2	116.4	114.9
May	117.6	117.2	107.1	107.1	108.7	108.4	127.5	126.7	116.7	115.2
June	118.0	117.5	107.2	107.4	109.3	108.6	128.0	127.2	117.1	115.5
July	118.4	118.0	107.4	107.7	109.5	108.9	128.5	127.8	117.6	115.7
August	118.8	118.4	107.6	107.9	109.3	109.2	129.1	128.3	118.0	115.9
September	119.2	118.8	107.8	108.1	109.7	109.5	129.6	128.9	118.4	116.2

Fore. = August Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

MISCELLANEOUS

	Merchandise Trade Balance		Leading Indicators		Estimated GNP		Estimated GNP (1982 \$)		IVA (annual rate)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1986	-14.02	-12.07	178.5	178.5	4167	4161	3671	3660	19.6	19.6
May	-14.27	-14.21	178.8	177.9	4173	4175	3667	3656	2.8	6.7
June	-12.46	-14.17	179.2	177.5	4207	4191	3661	3660	-7.7	2.5
July	-13.66	-16.06	179.6	179.4	4218	4204	3677	3669	-1.3	9.4
August	-12.93	-13.32p	179.9	179.1	4235	4219	3686	3678	15.8	13.6
September	-13.88	-14.83	180.3	179.4	4244	4232	3684	3683	22.7	13.0
October	-13.59	-14.52	180.1	179.6	4271	4254	3698	3686	10.3	5.6
November	-13.22	-14.23	180.3	179.4	4293	4275	3707	3692	-7.6	1.2
December	-12.67	-13.83	180.6	179.2	4316	4299	3714	3706	-18.7	-3.6
January 1987	-13.78	-15.26	180.2	178.9	4342	4311	3727	3704	-7.8	-6.5
February	-13.11	-15.02	180.0	179.1	4363	4334	3735	3714	-5.1	-8.4
March	-12.65	-14.27	180.5	179.5	4384	4347	3741	3715	-3.0	-5.6
April	-14.06	-13.63	180.2	179.8	4401	4364	3742	3720	-1.6	-3.5
May	-12.93	-13.94	179.6	179.9	4418	4383	3744	3721	-1.4	-2.8
June	-13.01	-13.56	179.2	179.5	4435	4405	3746	3730	-2.4	-4.9
July	-14.93	-15.27	178.6	179.2	4454	4419	3749	3729	-5.3	-6.3
August	-13.02	-15.01	178.8	179.5	4474	4440	3757	3734	-6.7	-6.8
September	-12.24	-13.84	179.2	179.8	4494	4464	3764	3742	-8.1	-7.5

Fore. = August Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.

FINANCIAL MARKETS

	Monetary Base		M1		M2		Federal Funds		T-Bills (6 Mos.)	
	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.
April 1986	239.9	239.9	646.1	646.1	2621.6	2622.3	6.99	6.99	6.08	6.08
May	242.3	242.3	658.6	658.7	2647.0	2649.7	6.85	6.85	6.19	6.19
June	244.2	243.4	666.3	666.8	2667.3	2670.5	6.92	6.92	6.27	6.27
July	245.6	245.5	673.7	676.1	2685.0	2699.1	6.52	6.56	5.85	5.86
August	247.2	246.8	679.6	687.8	2702.5	2723.6	6.36	6.17	5.79	5.55
September	248.8	248.9*	686.1	694.1*	2720.9	2741.6*	6.32	5.83*	5.81	5.28*
October	250.3	250.3	689.1	698.1	2735.4	2757.4	6.48	5.76	5.93	5.33
November	251.9	251.7	694.2	702.2	2749.6	2771.6	6.59	5.84	6.07	5.39
December	253.5	253.1	699.3	706.1	2763.5	2786.5	6.52	5.96	6.06	5.46
January 1987	255.2	254.8	704.6	711.1	2784.7	2805.2	6.41	5.64	5.91	5.13
February	256.9	256.3	710.3	715.1	2806.5	2819.9	6.22	5.37	5.79	4.98
March	258.6	258.0	715.4	719.8	2829.2	2836.4	6.51	5.28	5.94	4.95
April	260.3	259.6	718.4	723.8	2843.6	2851.2	6.69	5.35	6.01	5.06
May	262.1	261.4	722.9	729.0	2861.7	2810.7	6.78	5.39	6.04	5.10
June	263.9	263.3	727.4	734.6	2880.7	2890.8	6.87	5.43	6.04	5.17
July	265.3	265.0	733.0	739.6	2898.3	2909.5	6.45	5.56	5.83	5.20
August	266.4	266.3	737.7	743.0	2915.2	2923.9	6.40	5.75	5.80	5.28
September	267.5	267.6	740.6	746.6	2927.0	2940.1	6.42	5.98	5.80	5.43

	Aaa (Seasoned)		Municipals (Bond Buyer)		(3 Month) Commercial Paper		90 Day CD's		Prime Rate	
	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.	Fore	C.E.
April 1986	8.79	8.79	7.20	7.20	6.60	6.60	6.60	6.60	8.83	8.83
May	9.09	9.09	7.54	7.54	6.62	6.62	6.65	6.65	8.50	8.50
June	9.13	9.13	7.87	7.87	6.71	6.71	6.73	6.73	8.50	8.50
July	8.94	8.88	7.69	7.51	6.43	6.33	6.47	6.37	8.14	8.16
August	8.83	8.72	7.59	7.21	6.26	5.92	6.34	5.92	8.00	7.90
September	8.77	8.84*	7.47	7.14*	6.21	5.68*	6.30	5.63*	8.00	7.50*
October	8.89	8.80	7.51	7.08	6.53	5.60	6.63	5.60	8.00	7.50
November	9.03	9.02	7.68	7.31	6.62	5.75	6.72	5.79	8.00	7.50
December	9.20	9.17	7.85	7.46	6.55	5.98	6.65	6.05	8.00	7.50
January 1987	8.99	8.83	7.64	7.15	6.36	5.67	6.47	5.80	8.00	7.50
February	8.52	8.69	7.17	7.02	6.17	5.41	6.28	5.56	8.00	7.50
March	8.46	8.60	7.08	6.88	6.53	5.28	6.64	5.39	8.00	7.32
April	8.69	8.65	7.30	6.95	6.74	5.33	6.83	5.47	8.00	7.00
May	8.92	8.69	7.49	7.01	6.83	5.36	6.94	5.52	8.50	7.00
June	8.86	8.70	7.44	7.05	6.95	5.42	7.13	5.50	8.50	7.00
July	8.73	8.76	7.27	7.10	6.42	5.53	6.61	5.65	8.50	7.00
August	8.59	8.85	7.13	7.21	6.37	5.84	6.52	5.97	8.50	7.47
September	8.55	8.96	7.05	7.33	6.35	5.95	6.47	6.09	8.50	7.68

Fore. = August Forecast

C.E. = Current Expectations

* = This item and those beyond it are projections.